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PUBLIC UTILITY HOLDING COMPANY ACT

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HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER

OF THE

COMMITTEE ON ENERGY AND COMMERCE HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 5220, H.R. 5465, and H.R. 6134

BILLS TO AMEND OR REPEAL THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, AND FOR OTHER PURPOSES

JUNE 9, 1982

Serial No. 97-165

Printed for the use of the
Committee on Energy and Commerce

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PUBLIC UTILITY HOLDING COMPANY ACT

WEDNESDAY, JUNE 9, 1982

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:20 a.m., in room 2322, Rayburn House Office Building, Hon. Richard L. Ottinger (chairman) presiding.

Mr. OTTINGER. Good morning. Today the subcommittee will hear testimony on bills that would amend or repeal the Public Utility Holding Company Act of 1935. I understand that a Senate subcommittee is holding hearings on the act and that the electric and gas industries as well as the Securities and Exchange Commission take the position that Congress should repeal the act.

I would like to state that I have some severe concerns about that that I hope will be addressed in these hearings. I just am doubtful that the case has yet been made that repeal is in the public interest.

The industry and the SEC say that the States, together with the FERC and existing SEC securities regulation, will fill any regulatory gaps created by repeal of the act. However, I think it is very significant that NARUC feels that the States cannot adequately do that job. The present system is actually working, as I see it, quite well.

An intrastate utility holding company can proceed without SEC regulations and, within the State boundaries, the State has the capability of doing the regulation. To get to the 12 public utility holding companies that operate interstate, it is very difficult, as I see it, for any one State commission to be able to handle that job.

I think that there are very real concerns to which PUHCA addresses itself, the problem of cross subsidization, so that utilities don't use nonutility business, and drain the regulated utility business for the benefit of what may be more profitable nonutility operations, say.

I think that there are real concerns about very large companies coming in and taking hold of utilities and not having the kind of attention to utility business that is presently required under affected State regulation with respect to intrastate companies.

I think there is also a real danger that if PUHCA were repealed, that you would have a great number of new utility holding companies created, making the job of effective regulation even more difficult.

Today we have two very distinguished panels to enlighten us on PUHCA and the matter of repeal. The first panel consists of representatives of affected industries and consumers. I look forward to the interchange between these panelists.

The second panel consists of the regulators and includes Mr. York for NARUC and Commissioner Shad of the SEC and his Director of Corporate Regulation, Mr. Aaron Levy, a man with a long and distinguished history of service to the SEC and to his country, and who has been doing the operations of PUHCA for the SEC.

I would also like to express concern—and others may want to comment—on the manner in which the decision was reached at the SEC to advocate the outright repeal of PUHCA. The decision was made in a session that was closed to the public, without the benefit of prior consultation, with State utility commissioners. I think that that is a matter of real concern, on which we will be interested in receiving testimony.

[Testimony resumes on p. 19.]

[The text of H.R. 5220, H.R. 5465, and H.R. 6134 follow:]

I

97TH CONGRESS
1ST SESSION

H. R. 5220

To amend the Public Utility Holding Company Act of 1935 to improve financial performance of electric and gas utilities by removing unnecessary regulatory impediments to the exercise of sound and prudent business judgment by utility executives.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 15, 1981

Mr. COBCORAN introduced the following bill; which was referred to the Committee on Energy and Commerce

---

A BILL

To amend the Public Utility Holding Company Act of 1935 to improve financial performance of electric and gas utilities by removing unnecessary regulatory impediments to the exercise of sound and prudent business judgment by utility executives.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Public Utility Financial Reform Act".

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FINDINGS

SEC. 2. The Congress hereby finds that—

(1) the electric and gas utility industries in the United States, once strong and stable, are now experiencing serious and intractable financial difficulties, the consequences of which threaten the existence of these vital national resources, together with the citizens and industry of the United States dependent thereon;

(2) while there may be a number of alternatives available to remedy the financial difficulties confronted by the electric and gas utility industries, it is in the best interests of investors and consumers to encourage the most expeditious of those financial remedies;

(3) the diversification of a business portfolio, when done prudently, is recognized as both a technically and operationally sound means of improving corporate financial performance by spreading or countering business risk;

(4) prudently managed diversification into non-utility businesses is a normal business practice that could substantially improve the financial performance of certain electric and gas utilities;

(5) it is in the public interest to remove unnecessary and unintended regulatory impediments to the ex-

ercise of sound and prudent business judgment by utility executives;

(6) the Public Utility Holding Company Act of 1935 was intended to correct abuses in the manner in which the utility industry was then conducting its affairs; the legislative intent was not, however, to prevent or interfere with those normal and prudent business practices the benefits of which would accrue to both investors and consumers;

(7) certain provisions of the Public Utility Holding Company Act of 1935 nevertheless act to increase, rather than decrease, business risk in a manner that is detrimental to the interests of investors and consumers by effectively discouraging diversification by electric and gas utilities into nonutility businesses; and

(8) the amendment of the Public Utility Holding Company Act of 1935 to provide for the establishment of a new exemption for holding companies with a subsidiary public utility company meeting certain defined criteria and the establishment of definitive exemptions would be consistent with the public interest and the interests of investors and consumers and would eliminate those provisions which inhibit normal and prudent business practices.

STATEMENT OF PURPOSES

SEC. 3. The purposes of this Act are—

(1) to facilitate diversification by removing technical restrictions imposed by the Public Utility Holding Company Act of 1935 on those utilities prudently operating in the best interests of their investors and consumers that find it desirable and beneficial to diversify their business activities;

(2) to provide a new exemption under section 3 for a holding company with one subsidiary public utility company that operates in one or more States contiguous to the State in which such subsidiary public utility company is organized;

(3) to provide an exemption for holding companies created by companies that are presently exempt under section 3(a)(2) of the Public Utility Holding Company Act of 1935; and

(4) to provide definitive exemptions in subsection (a) of section 3 so as to reduce the regulatory impediments of the exercise of prudent business judgment related to diversification by such utilities.

AMENDMENTS TO THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

SEC. 4. Section 3 of the Public Utility Holding Company Act of 1935 is amended to read as follows:

"POWER TO MAKE PARTICULAR EXEMPTIONS REGARDING HOLDING COMPANIES, SUBSIDIARY COMPANIES, AND AFFILIATES

"SEC. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall unconditionally exempt any holding company, and every subsidiary company thereof as such, from all provisions of this title, except paragraph (2) of subsection (a) of section 9, if—

"(1) such holding company, and every subsidiary company thereof which is a public utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;

"(2) such holding company is predominantly a public utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;

"(3) such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public utility company and (A) not deriving, directly or indirectly, any material part of its income from any one

or more subsidiary companies, the principal business of which is that of a public utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all the outstanding securities of such companies are owned, directly or indirectly, by such holding company;

"(4) such holding company is temporarily a holding company solely by reason of the acquisition of securities for purposes of liquidation or distribution in connection with a bona fide debt previously contracted or in connection with a bona fide arrangement for the underwriting or distribution of securities;

"(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public utility company; or

"(6) such holding company has only one subsidiary public utility company and such subsidiary public utility company's operations as such do not extend beyond the State in which it is organized and States contiguous thereto.

"(b) If a holding company otherwise qualifies for an exemption pursuant to subsection (a) of this section, that ex-

emption shall not be affected by the ownership by a public utility subsidiary of such holding company of a public utility company provided that the ownership of such public utility company by the public utility subsidiary of such holding company is exempt pursuant to paragraph (2) of subsection (a) of this section.

"(c) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any subsidiary company, as such, of a holding company from any provision or provisions of this title, the application of which to such subsidiary company the Commission finds is not necessary in the public interest or for the protection of investors, if such subsidiary company derives no material part of its income, directly or indirectly, from sources within the United States, and neither it nor any of its subsidiary companies is a public utility company operating in the United States.

"(d) Within a reasonable time after the receipt of an application for exemption under subsection (a) or (c), the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of such application. The filing of an application in good faith under subsection (a) by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon such

application. The filing of an application in good faith under subsection (c) shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a subsidiary company, until the Commission has acted upon such application. Whenever the Commission on its own motion, or upon application by the holding company or any subsidiary company thereof exempted by any order issued under subsection (a), or by the subsidiary company exempted by any order under subsection (c), finds that the circumstances which gave rise to the exemption no longer exist, the Commission shall by order revoke such order.

"(e) The Commission may, by rules and regulations, conditionally or unconditionally exempt any specified class or classes of persons from the obligations, duties, or liabilities imposed upon such persons as subsidiary companies or affiliates under any provision or provisions of this title, and may provide within the extent of any such exemption that such specified class or classes of persons shall not be deemed subsidiary companies or affiliates within the meaning of any such provision or provisions, if and to the extent that it deems the exemption necessary or appropriate in the public interest or for the protection of investors or consumers and not contrary to the purposes of this title.

"(f) A holding company which is exempt under subsection (a) of this section may engage in any business (or busi-

nesses) whether or not any such business is incidental or necessary to the operation of a public utility company, but any such business (or businesses) which is not incidental or necessary to the operation of a public utility company shall be conducted through a separate nonutility subsidiary (or subsidiaries) of such holding company.".

I

97TH CONGRESS
2D SESSION

H. R. 5465

To repeal the Public Utility Holding Company Act of 1935 as no longer necessary to accomplish the purposes for which it was enacted.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 4, 1982

Mr. TAUZIN introduced the following bill; which was referred to the Committee on Energy and Commerce

---

A BILL

To repeal the Public Utility Holding Company Act of 1935 as no longer necessary to accomplish the purposes for which it was enacted.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

CONGRESSIONAL FINDINGS

SECTION 1. The Congress hereby finds that—

(1) the Public Utility Holding Company Act of 1935 imposes substantial and burdensome requirements upon the holding company sector of the public utility industry and the Act subjects utility holding companies to a level of regulation not found necessary with re-

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spect to other organizations in the same or related industries;

(2) the Public Utility Holding Company Act of 1935 continues to impose these requirements even though substantially all of the purposes of the Act have been achieved; public utility holding companies have been limited to single integrated public utility systems operating in cohesive geographic areas or regions; the simplification of the capital structures of public utility holding companies contemplated under the Act has been completed; public utility companies organized in holding company systems are subject to effective Federal, State, and local control, without the regulation of the 1935 Act;

(3) only a small number of public utility holding companies are regulated under the Act; those that remain regulated under the provisions of the Act are subject to registration and reporting requirements, as well as to other limitations on activities, that are not borne by other companies operating in the utility business, or elsewhere in industry;

(4) existing Federal and State registration and regulatory requirements are fully adequate to insure the protection of investors holding interests in public utility holding companies; the elaborate process of util-

ity registration under the Public Utility Holding Company Act of 1935 afford no greater protection than is afforded by the Securities Act of 1933 and the Securities Exchange Act of 1934; State utility regulatory commissions are now capable under familiar principles of regulatory law to review acquisitions and system transactions entered into by public utility operating companies and their affiliates;

(5) the requirements of the Public Utility Holding Company Act of 1935 are duplicative of other existing Federal and State requirements; State public utility commissions are competent to investigate whether utilities' acquisition of diverse businesses is likely to endanger the reliability of utility service, and are generally empowered to disallow costs charged by companies associated with utility companies which are not in the public interest; and

(6) it is in the public interest to eliminate the provisions of the Public Utility Holding Company Act of 1935 which inhibit innovation; these provisions have retarded the financial health of registered public utility holding companies relative to other companies and utilities; these provisions also provide disincentives to entry into the electric utility generating sector by other industries.

REPEAL OF PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

SEC. 2. The Public Utility Holding Company Act of 1935 (chapter 687, title I, 49 Stat. 803; 15 U.S.C. 79 to 79z-6 (1976)), is hereby repealed.

REPEAL OF RELATED PROVISION OF THE FEDERAL POWER ACT

SEC. 3. Section 318 of the Federal Power Act (chapter 687, title II, sec. 213, 49 Stat. 863; 16 U.S.C. 825) providing that any person subject to the requirements of both the Federal Power Act and the Public Utility Holding Company Act of 1935, shall be subject to the provisions of the Public Utility Holding Company Act of 1935 rather than to the provisions of the Federal Power Act with respect to the same subject matter, is hereby repealed.

SAVINGS PROVISION

SEC 4. This Act shall not be construed to affect any proceedings commenced as of the effective date of these provisions by an official filing with the Securities and Exchange Commission by any company subject to the provisions of the Public Utility Holding Company Act of 1935.

I

97TH CONGRESS
2D SESSION

H. R. 6134

To repeal the Public Utility Holding Company Act of 1935, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 21, 1982

Mr. COLLINS of Texas introduced the following bill; which was referred to the Committee on Energy and Commerce

---

A BILL

To repeal the Public Utility Holding Company Act of 1935, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

CONGRESSIONAL FINDINGS

SECTION 1. The Congress finds that—

(1) the Public Utility Holding Company Act of 1935 is no longer required to prevent the abuses and practices which led to its enactment;

(2) public gas and electric utilities organized as either exempt or nonexempt holding companies under such Act are subject to regulation under a broad array

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of other Federal and State laws which are adequate to prevent the recurrence of such abuses and practices and to protect consumers and investors;

(3) the Public Utility Holding Company Act of 1935 unnecessarily impedes utility managers without regulatory benefit from making investment and operational decisions in a manner which best promotes the financial health of utilities and the reliability of their services to consumers; and

(4) the Congress, through appropriate oversight activities, can review the activities of Federal and State regulatory agencies to assure that the interests of investors and consumers are adequately protected and can take appropriate action to supplement those authorities should such action be determined to be necessary or appropriate.

REPEAL OF ACT

SEC. 2. The Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.; 49 Stat. 803) is repealed.

REPEAL OF RELATED PROVISION OF THE FEDERAL POWER ACT

SEC. 3. Section 318 of the Federal Power Act (16 U.S.C. 825; 49 Stat. 863), providing an exemption from that Act for persons subject to the Public Utility Holding Company Act of 1935, is repealed.

SAVINGS PROVISION

SEC. 4. This Act shall not be construed to affect any enforcement proceeding instituted under the Public Utility Holding Company Act of 1935 prior to the date of enactment of this Act.

Mr. OTTINGER. Does the minority have an opening statement?

Mr. COLLINS. I have a statement, Mr. Chairman.

Mr. Chairman, I am pleased the subcommittee is reviewing the need for the reform or the repeal of the Public Utility Holding Company Act of 1935. We would do better, of course, to just completely repeal it.

I have introduced H.R. 6134 to repeal the act because there is compelling evidence to suggest that its goals, the simplification and the integration of the sprawling utility holding companies of the twenties and the thirties, have been achieved.

As the SEC wrote in 1977, "Congress did not intend that utilities would remain permanent Federal wards under the act." The continuation of the act presents an impediment to utilities in the development of new sources of capital, and it inhibits the entrance of new companies into electric generation, discourages cogeneration, and duplicates other Federal securities statutes.

A basic question of regulatory fairness must be raised in light of the fact that exempt and nonholding company utilities do not have to meet the strenuous reporting requirements of the act, while the 12 registered systems must. I would like to emphasize that. There are just 12 registered systems.

In short, as is well pointed out in the SEC's testimony, the act assumes the utility industry today should be structured as it was back in 1935. As this hearing will demonstrate, such an assumption is not well founded. As will be explained thoroughly this morning, the 1935 act's goals were achieved 20 years ago. Today the utility industry is in serious financial condition, and a continuation of the Holding Company Act is one of the many obstacles to its recovery.

The average electric utility has had its ratio of pretax earnings to debt service fall by more than one-third since 1970. Average utility dividends have fallen 30 percent in the same period, and return on the common equity for Standard & Poor's electrics during 1980, was less than 12 percent, while the S&P industrials were at 16 percent, which means electrics are getting a much lower return than industrials.

By any measure, the electric utility industry could significantly benefit from the opportunities to prudently diversify if the act were reformed or repealed.

A recent Cabot Consulting Group study projects that diversification by utilities could increase their rate of return in the 1984 to 1986 period from 10 to 20 percent. A full complement of Federal statutes will continue to regulate holding companies in the absence of the act. These include the major securities statutes of 1933 and 1934, the Trust Indenture Act of 1933, the Federal Power Act, and the Natural Gas Act. These laws assure that adequate information will continue to be made available to the public about utility holding companies.

Further—I think this is most important—the State utility regulation is sophisticated enough to deal with even so critical an issue as utility affiliate transactions. Many States require their prior approval of contracts with affiliates as well as of major corporate changes. Uniform and enforceable accountable standards, simpler capital structures resulting from the 1935 act, and key Supreme Court decisions that augment the power of States to control inter-

corporate transactions all make for viable State utility regulation in the absence of the act.

I am convinced that adequate protections exist for both ratepayers and investors if the Holding Company Act is repealed. I want to make two final points.

The Holding Company Act is expensive to comply with. The Edison Electric Institute indicates in its prepared testimony that most registered companies absorb direct costs of from $400,000 to $600,000 per year. Legal costs are on top of this. Some 69,000 hours were required in 1981 to complete 830 filings and applications.

No. 2, the subcommittee will hear today testimony that suggests the act should be retained to protect nonutility businesses from utility competition. The Holding Company Act is not an antitrust law and should not be retained to restrict competition. Unfair competition, should it occur, can be redressed through the generally applicable antitrust laws.

Thank you, Mr. Chairman.

Mr. SWIFT [presiding]. Thank you.

Does the gentleman from Illinois have a statement?

Mr. CORCORAN. I wonder if I could make a statement. First of all, Mr. Chairman, this is a red letter day for me because of two things. Mrs. Corcoran and I are celebrating our 20th wedding anniversary, and second, the hearing is being held on one of my bills. I am not going to assess which is more important.

Mr. SWIFT. You don't feel as old with the latter as you do with the former.

Mr. CORCORAN. But I would say that they are both unique occurrences these days.

Mr. Chairman, I have a prepared statement I would like to ask unanimous consent to put in the record.

Mr. SWIFT. Without objection.

Mr. CORCORAN. In connection with the bill to which I made reference, we surveyed the 50 State public utility commissions, and there are other statements that were made, some correspondence involving the Department of Energy, the Federal Energy Regulatory Commission, and the Securities and Exchange Commission. I would like those documents be included in the record also.

Mr. SWIFT. Without objection. [See p. 24.]

Mr. CORCORAN. Let me just say, Mr. Chairman, that the issue which confronts us I think is a relatively important one. I don't regard it as a panacea for curing all of the financial problems of the investor-owned utility industry, but I think to some extent—and I don't want to overemphasize the notion of a crossroads point, but as you well know, Mr. Chairman, over the past 2 or 3 years in particular, because of the financial problems to which our friend from Texas made reference, there have been a number of seminars and studies and debates, both inside the Government and outside the Government, regarding what can be done to strengthen the financial condition of our utility industry.

On the one hand, we have some suggestions that perhaps what we ought to do is deregulate the industry. There has been considerable discussion of that.

On the other hand, there has been discussion and unfortunately at least in my judgment some actual development along the lines

of having the Government take a more active role in the actual ownership of public power companies, and I would cite, for instance, the circumstance where ConEd sold some of its generating capacity to the New York Power Authority, so that is another route that could be taken.

We did it here during the last Congress with legislation to revise the Bonneville Power Authority. We have for years had the Tennessee Valley Authority and also in that part of the country there are some developments which indicate that there may well be a growing trend toward turning over some portion of the ownership of our public utility companies to public government authorities.

My own judgment is that we should not go in either extreme, and that in fact what we should try to do is strengthen our current system of investor-owned public utility companies, and, in that respect, I think that perhaps the No. 1 problem is to put some controls and further Federal discipline on our activities so that we can control inflation, because having come from an experience in the private sector where I worked in the railroad industry, I know that despite all of the charges about a monopoly, that in fact a monopoly for utilities only exists with respect to price. It doesn't exist with respect to cost.

And so what you have particularly for our utilities is the ever-increasing burden of inflation. As we bring that under control, I think we will in large measure solve some of the problems that they have experienced over the past 10 or 15 years, but at the same time I think that there are some legal impediments we should address.

I think that there are some obstacles to further improvement of the financial condition of the utilities, whether from the standpoint of attracting new capital or the standpoint of their desire to diversify. I think in that respect the Public Utility Holding Company Act is one example.

It was enacted in 1935, nearly 50 years ago. It is not without some irony that I would report that a young attorney named Tom Corcoran, who at that time was an adviser to then President Franklin Roosevelt, was the drafter of that legislation.

Now I am involved in legislation for some modification or ultimately repeal of the legislation, but nonetheless I think there have been a lot of changes in this country since 1935. I think from the standpoint of the circumstances of the utility industry itself, that there have been a number of significant changes, and that is why I commend the chairman of this subcommittee for holding these hearings.

At a minimum, we at least ought to be willing to examine and review and analyze what the effect of that statute is in today's world. So I am pleased, Mr. Chairman, that we are going to hear from our witnesses on these questions.

[Testimony resumes on p. 267.]

[Mr. Corcoran's prepared statement and attachments follow:]

SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER

HEARING ON PUBLIC UTILITY HOLDING COMPANY

June 9, 1982

REMARKS OF THE HONORABLE TOM CORCORAN

I welcome our witnesses. This hearing is the result of strong bipartisan interest in our Committee in favor of substantial reforms to the Holding Company Act.

Last December, I introduced H.R. 5220, a comprehensive package of reforms of the Act designed to reduce the regulatory burdens of the Act on financially-pressed utilities and attract new sources of capital, innovative management, and diversified fuel sources into our essential electric and gas utilities.

I am very pleased at the response my legislation has received on both sides of the Hill. Last April, over a dozen Members of our Committee joined with me in requesting legislative hearings on my bill. In addition, I am pleased that Congressmen Jim Collins and Billy Tauzin have also introduced similar bills to reform the Act.

Finally, I commend Chairman Dick Ottinger for the leadership he has shown in scheduling hearings on this legislation, as well as the entire panoply of utility financial issues which are now front-and-center in our energy policies. Dick Ottinger has truly become "the" expert on Capitol Hill on electric utility issues.

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I have an open mind on reforms of the Holding Company Act. I do not intend to rush to judgment on the merits of any particular approach to legislation. But I do think there is a consensus in our Committee on two broad principles:

First, utilities are in deep financial trouble, and any Federal agency, including the SEC, must carry a very heavy burden to justify its continued regulation of such utilities.

Second, we can no longer assume that utilities must remain forever immune from the disciplines of the free market and competition through public regulation. We must begin to re-examine the justification for insulating utilites from competition.

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TOM CORCORAN
15th District, Illinois

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
POST OFFICE AND CIVIL SERVICE COMMITTEE
SUBCOMMITTEE ON HUMAN RESOURCES
SUBCOMMITTEE ON FISCAL OPERATIONS AND SERVICES

Congress of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE:
1107 Longworth House Office Building
Washington, D.C. 20515
(202) 225-2976

ILLINOIS OFFICES:
203 North Lake Street
Aurora, Illinois 60506
(312) 897-2220

100 West Lafayette Street
Ottawa, Illinois 61350
(815) 434-5566

Illinois Toll-Free Action Line
(800) 942-0027

July 6, 1982

The Honorable Richard L. Ottinger
Chairman, Energy Conservation and
Power Subcommittee
Energy and Commerce Committee
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

In connection with the subcommittee's June 9 hearing on the Public Utility Holding Company Act, I am enclosing material for the record of the hearing. As indicated at the hearing, I am enclosing material relating to my October 27, 1981, survey of utilities and state public utility commissions, my December 15, 1981, Congressional Record statement in connection with my introduction of H.R. 5220, and correspondence relating to that legislation involving the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Department of Energy.

In addition, I would like to include in the record the enclosed statements by the Department of Energy, the Department of Justice, Duke Power Company, and the Cabot Corporation. These statements were all made in connection with Senator D'Amato's June 3 and 10 hearings on the Holding Company Act. Of course, if you plan any subsequent Holding Company Act hearings, then perhaps these statements could be entered into the record in connection with those hearings. Otherwise, I would hope that these statements could be entered into the record in connection with our June 9 hearing.

I appreciate your holding the June 9 hearing, and I look forward to working with you in connection with utility financing issues. Please let me know if I can be of any assistance.

Sincerely,

Tom Corcoran
Representative in Congress

Encs.

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TOM CORCORAN
15th District, Illinois

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS

POST OFFICE AND CIVIL SERVICE COMMITTEE
SUBCOMMITTEE ON HUMAN RESOURCES
SUBCOMMITTEE ON POSTAL OPERATIONS AND SERVICES

Congress of the United States

House of Representatives

Washington, D.C. 20515

October 27, 1981

WASHINGTON OFFICE:
1107 Longworth House Office Building
Washington, D.C. 20515
(202) 225-2976

ILLINOIS OFFICES:
205 North Lake Street
Aurora, Illinois 60506
(312) 897-2220

100 West Lafayette Street
Ottawa, Illinois 61350
(815) 434-5060

Illinois Toll-Free Action Line:
(800) 942-0837

Tom Corcoran staff contact: Al Cobb, 202/225-9106
The text of this letter (with the bracketed part modified as appropriate) with the attached one-page enclosure was sent on about October 28 to the below-listed categories:

1. Registered holding companies	12
2. Exempt holding companies filing statements/rule 2	56
3. Holding companies exempt by order	22
4. Selected independent operating companies	50
5. State public utility commission chairmen	50

Mr. Charles Finch
Allegheny Power System, Inc.
320 Park Avenue
New York, New York 10022

Dear Mr. Finch:

Concern seems to be growing about the financial plight of the utility industry. The high cost of money, the uncertain economic outlook, and the changing government regulatory environment all work against [your industry.]

While the President's attempts to reduce federal deficit spending will hopefully reduce interest rates, and while the recently enacted tax law will hopefully spur economic growth, the difficulties created by government regulation still remain. It is this issue that I would like to discuss here.

While many federal laws (such as the Clean Air Act) directly impact utilities, and while utility regulation is primarily a state matter, one federal law, the Public Utility Holding Company Act of 1935, directly affects the organization of the utility industry. PUHCA is under the jurisdiction of the House Energy and Commerce Committee's Energy Conservation and Power Subcommittee, of which I am a member.

At a September 10 Energy Conservation and Power Subcommittee hearing on utility "least-cost strategies", I made reference to the Holding Company Act by stating that I was considering legislation relating to that law. My main interest is in the possibility of removing federal statutory and regulatory barriers that may inhibit the ability of utilities to financially help themselves and their stockholders and ratepayers.

I have enclosed a discussion paper on two approaches to PUHCA. I would be interested in your comments from your perspective as representing [a registered holding company.] Please feel free to expand your comments in any way you think appropriate. Even if you think the status quo is serving your interests well, please let me know that.

While there is no actual PUHCA legislation pending at this time, the Chairman of the Energy Conservation and Power Subcommittee has indicated that he intends to pursue the issue of utility financing strategies in future hearings. It may be useful to try to focus our attention on PUHCA in this connection, and so I would appreciate hearing from you by November 25.

Sincerely,

Tom Corcoran
Representative in Congress

Enclosure
cc: [EEI]
[NARUC]

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TOM CORCORAN
15th District, Illinois

Energy and Commerce Committee
Subcommittee on Energy Conservation and Power
Subcommittee on Fossil and Synthetic Fuels

Post Office and Civil Service Committee
Subcommittee on Human Resources
Subcommittee on Postal Operations and Services

Congress of the United States
House of Representatives
Washington, D.C. 20515

Washington Office:
1107 Longworth House Office Building
Washington, D.C. 20515
[illegible]

Illinois Offices:
[illegible] North Lake Street
Aurora, Illinois [illegible]
[illegible]

[illegible] West Lafayette Street
Ottawa, Illinois [illegible]
[illegible]

Illinois Toll-Free Action Line
[illegible]

October 27, 1981

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
Two Legislative Approaches:

APPROACH ONE: Repeal the PUHCA with provisions stating that such repeal would not affect any PUHCA proceedings previously commenced.

Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct? Please specify.

Question 2: To what extent would federal and state law adequately protect the interests of stockholders and ratepayers were PUHCA to be repealed?

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

APPROACH TWO: Amend Section 3 of PUHCA, first, to exempt holding companies with only one public utility subsidiary, provided such subsidiary's operations are limited to its state of incorporation and contiguous states; second, to exempt holding companies created by companies that are presently exempt under Section 3(a)(2) of the Act; and, third, to remove the "unless and except" clause.

Question 1: To what extent, if any, would this approach lead to utility diversification?

Question 2: In your opinion, how would enactment affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would enactment lead to diversification?

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CHARLES B. FINCH
President

Allegheny Power System, Inc.
320 Park Avenue, New York, N.Y. 10022 (212) 752-2121

Principal Subsidiaries:
Monongahela Power Company
The Potomac Edison Company
West Penn Power Company

November 2, 1981

Hon. Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

Thank you for your letter of October 27, 1981.

In our judgment neither the repeal nor amendment of the Public Utility Holding Company Act would affect the financial plight of the utility industry. That plight is a direct result of the failure of state regulatory commissions to price electricity at its true cost, including the cost of the very large amounts of capital needed to build environmentally acceptable generation, transmission, and distribution facilities.

You ask particularly about diversification. I am told by our counsel that the Securities and Exchange Commission has authority under the Holding Company Act to permit the kind of diversification that most utilities are talking about. But the main point about diversification is that it is not a substitute for bad regulation. It will not help the financial plight of utilities and might well end up adversely affecting the quality of their service.

Sincerely yours,

CBF:bg

P.S. My recollection is that your namesake was one of the originators of the Holding Company Act.

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PUBLIC SERVICE COMPANY OF OKLAHOMA
A CENTRAL AND SOUTH WEST COMPANY

P O BOX 201 / TULSA OKLAHOMA 74102 / (918) 583-3611

BOOTH MOFFETT
VICE PRESIDENT, PUBLIC AFFAIRS

PSO

November 5, 1981

The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Corcoran:

Your letter of October 27, 1981, addressed to Mr. Fate has been forwarded to me for reply. Mr. Fate is on leave for several months and his correspondence is being handled by others.

Public Service Company of Oklahoma is a wholly owned subsidiary of Central and South West Corporation and as such could not respond as "an independent operating company."

Should you like us as a subsidiary to address your legislative approaches, we would be pleased to respond.

Very truly yours,

EBM:ed
cc: M. E. Fate

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PUBLIC SERVICE COMPANY OF OKLAHOMA
A CENTRAL AND SOUTH WEST COMPANY

P.O. BOX 201 / TULSA, OKLAHOMA 74102 / (918) 599-2000

BOOTH MOFFETT
VICE PRESIDENT.

PSO

January 18, 1982

See also response of Nov. 5, 1981

The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Corcoran:

Your letter of December 23, 1982, addressed to Mr. Fate has been forwarded to me for a reply.

In our response to your October 27, 1981 letter I stated that Public Service Company of Oklahoma is a wholly owned subsidiary of Central and South West Corporation and that we would not respond "as an independent operating company." I feel that the response from Central and South West Corporation will necessarily suffice for Public Service Company.

Very truly yours,

Booth Moffett

EBM:ed

DATE ANS: DOC #:
REC #
JAN 22 1982

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KANSAS CITY POWER & LIGHT COMPANY
1330 BALTIMORE AVENUE
P.O. BOX 679
KANSAS CITY, MISSOURI 64141

SAMUEL P. COWLEY
VICE PRESIDENT AND SECRETARY

November 6, 1981

Hon. Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Corcoran:

This will respond to your letter to Arthur J. Doyle, Chief Executive Officer of Kansas City Power & Light Company regarding the Public Utility Holding Company Act.

Our Company is not now a holding company and we presently have no plans to become one nor do we have any intentions at this time to diversify to the point that the Holding Company Act would cause us a problem. We are not in a position to provide any significant input to your survey of utility companies on the proposed legislation. However, we are interested in and do expect to follow the Utility Holding Act legislation.

Sincerely yours,

spc-rb

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Commonwealth Edison
One First National Plaza, Chicago, Illinois
Address Reply to: Post Office Box 767
Chicago, Illinois 60690

Tom —
Good night R

November 6, 1981

DATE ANS:
AIDE: DOC #:
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DATE IN:
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Honorable Tom Corcoran
1107 Longworth House Office
Building
Washington, D. C. 20515

Dear Tom:

Thank you for your October 27 letter concerning the Public Utility Holding Company Act. You noted that concern is growing about the financial plight of the utility industry. It is unfortunate, and harmful to our national interest, for the electric utility industry to be in its present financial plight. The fact that many persons outside the industry, including regulators and legislators, are recognizing the industry's financial problems and becoming concerned about them is encouraging and, I hope, offers the chance to do something about the situation.

You asked whether changes to the Public Utility Holding Company Act, or its outright repeal, could help the industry's financial condition without compromising the public interest. In general, I believe that the Holding Company Act has outlived its usefulness. The combined regulatory spheres of state public service commissions, the Federal Energy Regulatory Commission, and the Securities Exchange Commission under the Securities Act and Securities Exchange Act are adequate to protect investors and customers from the kinds of concerns which led to the passage of the Act during the Depression. The FERC regulates wholesale power transactions among the members of holding company systems. State commissions carefully monitor utility security sales as, of course, does the SEC. State commissions are also much more sophisticated in analyzing and regulating sales of goods and services within families of associated companies than they were 50 years ago.

You asked whether repeal of the Public Utility Holding Company Act would result in conflicting state regulation and whether there is adequate public confidence in state public service commissions to reduce the federal role in regulation of local utilities. Since we are, for all practical intents and purposes, regulated by only one state public service commission, I am not in a position to say much about the possibilities of conflict. My impression, however, is that

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the Holding Company Act does not serve to limit conflicting state regulation and that repeal of the Act would not promote conflict. Regarding your second question, I do think the public has confidence in state regulatory commissions. To the extent there is not public confidence, the solution lies in improving the quality of the state commissions, not in more federal regul- ion. Finally, you asked what effect repeal of the Holding Company Act would have in Illinois. I think the effect would be quite small, at least as far as electric utilities are concerned. None of the electric utilities in this state is now part of a registered holding company system and, particularly in view of the Peoples Gas situation, I am sure that the Illinois Commerce Commission would consider any plan to form a holding company very carefully.

As an alternative to outright repeal of the Public Utility Holding Company Act, you asked about an amendment which would expand certain of the exemptions currently available under the Act. If the Act is not repealed, I believe that such an amendment would be an excellent idea. It would allow companies like ours greater freedom to clearly separate their utility and non-utility businesses. You asked whether this would lead to greater diversification by utilities. In some cases it might, where the utility is in a financial position to diversify advantageously. I think, however, that the greatest impact would not be to encourage diversification, a good part of which is already permissible for a company like ours, but to separate utility and non-utility operations. Such separation is fair to both investors and ratepayers. If a non-utility enterprise is unsuccessful, the utility's customers will be insulated from the impact. On the other hand, if a non-utility business is successful, there will be less pressure on regulators to unfairly appropriate for the utility customers benefits which properly belong to the stockholder.

I hope my response has been of some help to you. Please let me know if I can do anything further.

Sincerely,

James J. O'Connor
Chairman and President

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VIRGINIA ELECTRIC AND POWER COMPANY
RICHMOND, VIRGINIA 23261

November 9, 1981

T. JUSTIN MOORE, JR.
CHAIRMAN OF THE BOARD
AND
CHIEF EXECUTIVE OFFICER

The Honorable Thomas Corcoran
U. S. House of Representatives
House Office Building
Washington, D. C. 20515

Dear Congressman Cocoran:

Thank you for your letter of October 27, 1981 requesting our comments on the Public Utility Holding Company Act of 1935 (PUHCA).

As an independent operating public utility not currently subject to the PUHCA, the primary impact the Act has had on my Company over the years has been to impose restraints on the decision making process whenever any activity was contemplated which would have required a change in corporate structure that might have threatened our Company becoming a Regulated Holding Company under the PUHCA.

It has been our opinion that the regulatory burdens under the Act so inhibited financing flexibility and organizational and operational prerogatives that any activity which could cause the Company to be regulated under the Act should be avoided.

As you note in your letter, the principal interest in amending the Act comes from the belief that public utilities are restricted by the Act from diversification activities which might, if successful, allow utilities to improve their earnings through less regulated activities and thereby improve the financial condition of the regulated business.

In response to your October 27, 1981 position paper questions, we have the following answers:

> Either approach would be an improvement over the current situation and would allow freedom to consider diversification through the Holding Company structure.

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Approach One

Question 1 - A company such as ours does not present any problems contemplated by the Act. Hence, the reason that the present Section 3 exemptions were written into the Act.

Question 2 - In our case current state statutes duplicate the protection for which the Act was designed.

Question 3 - No

Question 4 - In our opinion, the answer is yes.

Question 5 - Repeal would allow the consideration by this Company of diversification opportunities under a Holding Company structure.

Approach Two

Question 1 - This approach would also allow our Company to consider diversification using the Holding Company structure, although there would be somewhat less flexibility than under Approach One.

Question 2 - Enactment would place more authority in the hands of State PUC's; stockholders return opportunities would improve; ratepayers would not be affected until a diversification investment was made. A successful diversification investment would lower the cost of equity capital and the overall cost of capital thereby lowering future revenue requirements for the entire enterprise. The converse would occur with an unsuccussful diversification attempt if the size of the investment were material.

The opportunity exists in varying degrees for every other industry in the United States to diversify its risk in order to avoid or shelter its primary business from periods of business distress. Why should the electric utilities be denied this opportunity?

Thank you for the opportunity to comment on your worthwhile legislative activity.

Yours very truly,

T. Justin Moore, Jr.

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VIRGINIA ELECTRIC AND POWER COMPANY
RICHMOND, VIRGINIA 23261

January 28, 1982

See also response of Nov. 9, 1981

O. J. PETERSON, III
VICE PRESIDENT
AND TREASURER

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Corcoran:

Justin Moore gave to me your letter of December 23 regarding H.R.5220 which you have introduced to amend the Public Holding Company Act. I apologize for the delay in replying to your letter, but with the holidays, the bad weather and my travel schedule, I have fallen behind on correspondence.

You had inquired about our views on amendment or repeal of the PUHCA. We believe that Congress should, at the very least, broaden the exemptions available under that statute, for the very reasons that you stated in your remarks introducing H.R.5220, but we also strongly support repeal of the PUHCA, provided that the introduction of such a repeal legislation has some reasonable chance of success and does not result in amendment legislation being dropped. The worst possible result, from our point of view, would be that no legislation of any sort is adopted.

Sincerely yours,

O. J. Peterson, III

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BANGOR HYDRO-ELECTRIC COMPANY
ELECTRIC LIGHT AND POWER PUBLIC SERVICE SERVING EASTERN MAINE
33 State Street, P.O. Box 932, Bangor, Maine 04401 Tel. 207-945-5621

November 10, 1981

Hon. Tom Corcoran
Representative in Congress
1107 Longworth House Office Building
Washington, DC 20515

Re: Public Utility Holding Company Act of 1935

Dear Rep. Corcoran:

Your letter of October 27 to Mr. Haskell has been forwarded to me for reply.

Bangor Hydro is only incidentally a "holding company" which must seek exemption under the Holding Company Act. This occurs as a result of a minority equity interest (about 14%) in a transmission company here in Maine. Accordingly, other than reviewing the exemption request each year and paying the fee, we have no experience under the Act.

However, like other utilities we are looking at the possibility of diversification or reorganization in order to adjust to present and future challenges. We would pursue these steps if we determine that they are necessary or desirable in order to better accomplish our business as a public utility. We think there is a fundamental distinction between this sort of diversification, and diversification in response to a perceived adverse regulatory climate or in hopes of augmenting poor utility financial results.

Given this framework, we consider the Act to be of minimal concern. However, to the extent the Act limits our ability to accomplish what we otherwise may determine to be best for the Company, its ratepayers and its stockholders, we think it should be changed.

However, I am not sure how one would draft a statute that could differentiate between those companies that are diversifying or reorganizing in order to support the basic public utility business, and those that are taking such steps in order to branch away from the public utility business. Arguably the latter ought to be subject to at least some of the oversight which the Act seeks to provide.

I hope these general comments are of some assistance.

Very truly yours,

RSB:p

Robert S. Briggs, Esq.
Vice President and General Counsel

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MONTANA-DAKOTA UTILITIES CO.

400 NORTH FOURTH STREET - BISMARCK, ND 58501 - TEL. (701) 222-7900

November 13, 1981

The Honorable Tom Corcoran
Representative in Congress
Congress of United States
House of Representatives
1107 Longworth House Office Building
Washington, DC 20515

Dear Congressman Corcoran:

Thank you for your letter of October 27, 1981. I share your concern regarding the financial plight of the utility industry, and am pleased that you, as a lawmaker, are reviewing this matter.

I agree with you that although there are many factors which contribute to the depressed economic outlook of the utility industry, these factors presently are basically a matter of state law; however, there is one Federal law, the Public Utility Holding Company Act of 1935 which does affect the organization of the utility industry, which in turn, does have an effect on the financial status of the industry as a whole.

Upon reviewing your approaches, I do not feel that it is necessary to completely repeal the Public Utility Holding Company Act of 1935; and therefore, I endorse Approach No. Two as outlined by you, which involves (1) an amendment to the Act creating a new exemption for holding companies that have only one subsidiary public utility company and which does business only in the state in which it is organized and states contiguous thereto; and (2) to provide that the exemption contained in Section 3 of the Act, as amended, shall be unconditional and thus not subject to review by the Securities and Exchange Commission.

I believe this approach would leave the 1935 Act basically in tact, but would permit, on a very limited basis, creation of a holding company involving a public utility, if that utility limited its utility activities to the state in which it is incorporated or in states contiguous thereto. I also wholeheartedly endorse the second portion of your approach regarding the unconditional exemption. As you know, under the existing law, the exemption contained therein, is not unconditional, and thus a Company could be forced to divest either its electric or gas business if it is a combined company, and could be forced to sell a non-utility business. Because of this risk, most utility companies heretofor have not sought an exemption.

If I or my staff can be of any assistance to you or furnish any information which will assist you in your review of this matter, please contact me at any time.

Sincerely,

J. A. Schuchart
President and Chief
Executive Officer

nf

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NORTHEAST UTILITIES
NU
THE CONNECTICUT LIGHT AND POWER COMPANY
THE HARTFORD ELECTRIC LIGHT COMPANY
WESTERN MASSACHUSETTS ELECTRIC COMPANY
HOLYOKE WATER POWER COMPANY
NORTHEAST UTILITIES SERVICE COMPANY
NORTHEAST NUCLEAR ENERGY COMPANY

P. O. BOX 270
HARTFORD, CONNECTICUT 06101
(203) 666-6911

WALTER F. TORRANCE, JR.
SENIOR VICE PRESIDENT AND GENERAL COUNSEL

November 13, 1981

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Congressman Corcoran:

Northeast Utilities is pleased to respond to your letter of October 27 asking our views on the Public Utility Holding Company Act of 1935. Lee Sillin, to whom your letter is addressed, is presently away, and I am responding to your inquiry on his behalf.

As you may be aware, the Northeast Utilities system is a registered holding company system subject to regulation under PUHCA and is one of less than 15 such registered systems. We provide electric and gas service in Connecticut and electric service in western Massachusetts.

We reviewed the two approaches to PUHCA covered in the discussion paper with your letter. Approach Two deals with the status of public utility holding company systems which are exempt from registration under PUHCA. Since this is not our status, our comments which follow are focused on Approach One.

Our response to the five questions on Approach One is as follows:

Question 1. The problems of size and structural completeness which PUHCA was intended to correct have, in our judgment, been corrected for all of the remaining registered holding company systems. For example, our holding company structure is typically simple and lacking in complexity, with a non-operating holding company and four principal operating subsidiaries, each of which is a direct subsidiary of the holding company.

Our service area is confined to two states.

Question 2. In our judgment, the existing state regulations should adequately protect the interests of stockholders and ratepayers if PUHCA were to be repealed. This is clearly so in the financing area in which the bulk of SEC's current activity is concentrated.

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However, we are not satisfied at this point that complete repeal is necessary. It may well be more appropriate at this time simply to modify some of the outdated provisions of PUHCA to lighten regulatory burdens and eliminate duplication. In particular, we would urge modifications that would amend PUHCA to open the way for diversification, permit us greater flexibility in our financing with a lighter regulatory burden and ease some of the rules on intercompany transactions. In addition, we have a special problem because of the PUHCA mandate that we dispose of our gas properties, despite the adverse impact that this would have both on our customers and our shareholders.

Question 3. In our judgment, it is unlikely that repeal of PUHCA would result in conflicting state regulations.

Question 4. So far as public confidence in the state commissions is concerned, it is important to recognize that public focus in the states has been on rate regulation, an area in which the SEC under PUHCA plays no role. In the areas where the state commissions provide regulation that is duplicated by what the SEC does under PUHCA, such as the financing area, the diversification area and the area of intercompany transactions, there appears to be no lack of public confidence in the state commissions. Thus, repeal of PUHCA, or a loosening of regulation in these areas, should cause no significant change in local regulation, at least in Connecticut and Massachusetts, and I see no reason why the public should have any less confidence in the performance of the state commissions in these areas.

Question 5. In our opinion, repeal of PUHCA, or its modification in the areas that I have suggested above, should have no significant adverse effect on our state commissions, ratepayers, utility companies or their shareholders. The action would clearly be beneficial to our companies and to our shareholders in reducing regulatory burden and thereby facilitating more effective management. So far as diversification is concerned, we believe that this could be beneficial both to us and our shareholders and to our ratepayers.

Again, I would like to thank you for the opportunity to respond to your letter. We expect to be actively involved in any legislative effort to repeal or modify PUHCA.

Very truly yours,

Walter F. Tower, Jr.

Senior Vice President
and General Counsel

WFT.JR:JES

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minnesota power / 30 west superior street / duluth, minnesota 55802 / telephone 218-723-3991

John F. McGrath - senior vice president, general counsel and secretary

November 12, 1981

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D. C. 20515

Sir:

Thank you very much for your letter regarding modification of the Public Utility Holding Company Act. Your letter to Mr. Rowe has been referred to me for response because I have been working on this problem.

We heartily support Approach No. 2 as set forth in your letter for amending the Holding Company Act. The adoption of that approach would, in our judgment, permit public utilities to diversify into areas which are not necessarily "functionally related" to the utility business. It is our opinion that there are areas in which utilities could diversify and enhance the earnings of the company to the betterment of the shareholders and, by strengthening its financial position, enhance the reliability of service to ratepayers. Stable and financially solvent, utilities would be in a position to continue supplying service at reasonable rates. Without such an amendment, the utility companies are restrained from diversifying into many areas through fear of losing their exemption particularly because of the "unless and except" clause of Section 3 of the present Act.

We sincerely appreciate your interest in this matter. I urge your support of legislation which will amend the Act in accordance with Approach No. 2 as set forth in your communication.

Very truly yours,

John F. McGrath

JFMcG:es

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Duquesne Light Company 435 Sixth Avenue
Pittsburgh, Pennsylvania
15219

JOHN M. ARTHUR
Chairman of the Board and
Chief Executive Officer

November 18, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

This is in response to your letter of October 27 requesting comments from the perspective of an independent operating company on the two approaches for amendment of the Public Utility Holding Company Act set forth in the discussion paper enclosed with your letter.

Duquesne recognizes that the existing structure of the Public Utility Holding Company Act presents substantial obstacles to an independent electric utility considering diversification into non-utility enterprises. We also recognize that the Act provides substantial limitations on the activities of registered holding companies. With today's high level of scrutiny of electric utility rates, operations and accounting during lengthy rate proceedings, either at the State or Federal level, and often both, I question whether the Public Utility Holding Company Act is any longer necessary for protection of customer's interests.

Indeed, there appears to be some basis for concern that in today's restrictive regulatory climate the Act may very well work to the detriment of customer's interests. Faced with today's high cost of new capital, repeal of the Act may prove a possible way for utilities to improve their financial conditions and thereby attract new capital at more favorable rates.

We can agree that most electric utilities are facing difficult financial problems and that restrictive governmental regulation has played a large part in creating such conditions. While such regulation may serve short term interests to minimize electric rate increases, we must recognize that keeping the price of electric too low for too long will ultimately result in shortages of supply, with attendant social and economic consequences, and higher ultimate costs in the future for electric service.

From Duquesne's perspective, we cannot say that we would favor Approach One or Approach Two set forth in your discussion paper as both approaches have merit. Although Duquesne is not a part of a holding company system, we do not believe that Federal or state legislation should preclude any electric company from making decisions related to diversification which are in the best interests of the public, its shareholders and its customers.

We wish to thank you for your recognition and concern for the serious financial problems faced by the electric utility industry and encourage you to fully explore with all responsible interest groups the possible benefits from amendment or repeal of the Public Utility Holding Company Act.

Sincerely yours,

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MISSISSIPPI POWER & LIGHT COMPANY
Helping Build Mississippi
P. O. BOX 1640, JACKSON, MISSISSIPPI 39205

DONALD C. LUTKEN
PRESIDENT

November 18, 1981

Honorable Tom Corcoran
United States Representative
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Corcoran

I share your interest in either amending or repealing the Public Utility Holding Company Act expressed in your letter of October 27, 1981. My clear preference is for repeal.

Rather than respond directly to your questionnaire, I am attaching a discussion memorandum which addresses the thrust of your questionnaire.

I view the Act as redundant and duplicative of other federal initiatives. It may have served a useful purpose in the 30's but it is hardly appropriate in today's real world.

If we can cut away the cumulative legislative and regulatory debris that frustrates sound, intelligent business practices we will have gone a long way toward restoring the health of our industry.

Thanks for your interest.

Sincerely

Donald

DCL:sb

Attachment

cc - System Chief Executive Officers - wo/attachment
System Public Affairs Committee - wo/attachment

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Repeal of the Public Utility Holding Company Act of 1935

The Public Utility Holding Company Act of 1935 ("PUHCA") is New Deal legislation that has served to remedy abuses accompanying the concentration of control over electric and gas utilities once exercised by a few large holding companies, operating in disparate parts of the nation during the early 30's without effective state regulation. In the view of Congress, the power and interstate character of these holding companies rendered state control over these abuses ineffective at that time and required that authority over them be conferred upon a federal agency, the Securities and Exchange Commission ("SEC" or "Commission"). The primary aim (and outcome) of the legislation, therefore, was to reorganize these holding companies into geographically contiguous units and thereby restore effective state control.

The PUHCA still imposes a series of federal controls on utility holding companies, their service and operating companies, and their other subsidiaries which are far broader and more comprehensive than those imposed upon any other industry. These controls fall into three broad categories: 1) registration of the holding company; 2) corporate simplication and geographical integration of holding companies; and 3) regulation of numerous business transactions.

Registration under the PUHCA is fairly similar to the filing of a registration statement under the Securities Act of

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1933 ("33 Act"). Disclosure of information through a PUHCA filing is intended to assist the Commission in its regulatory task rather than to enlighten the investing public, and the Commission on its own initiative has required far more detailed information. L. Loss, Securities Regulation 134 n.12 (2d ed. _____). Beyond this initial disclosure obligation, the PUHCA is duplicative of certain important provisions of the Securities Exchange Act of 1934 ("34 Act") regulating the solicitation of proxies, imposing liability for insider trading, and depriving directors and officers of short swing profits. §§ 12(e), 11(g); § 17(a); § 17(b). Thus, in the securities area, the PUHCA is essentially a more elaborate and unnecessary recapitulation of other existing federal statutes.

The heart of the PUHCA when enacted in 1935 was the provision in section 11 that utility holding companies should undergo a simplificiation of their corporate and capital structures and should be geographically integrated. The pyramiding practiced during the early thirties by some holding companies created capital structures that, by their complexity, were viewed as defying regulation. This necessitated, as a first step, that the SEC undertake capital reorganizations, with the goal of ensuring that "the holding company system does not unduly or unnecessarily complicate the [corporate] structure, or unfairly or inequitably distribute voting power among security holders." § 11(b)(2). Standing alone, simplication of holding companies' capital and corporate

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structure was viewed as not sufficient to achieve the Act's basic goal of making the utility operating company more amenable to local control. In order to achieve this goal, Section 11(b)(1) empowered the Commission to reorganize public utility systems, with the goal of limiting them to "a single integrated public utility system" operating in a single geographic area or region. In many instances, these reorganizations required holding companies to divest themselves of geographically diverse companies. In only two situations did the Act provide for exceptions. A holding company could retain an additional integrated utility system if the company could demonstrate to the satisfaction of the SEC that the additional system was necessary economically and would not impair localized management or the effectiveness of regulation. § 11(b)(1). Second, the holding company could also retain other businesses which "are reasonably incidental, or economically necessary or appropriate." With these two limited exceptions, however, the PUHCA was intended to, and has created streamlined and geographically unitary utility systems and has thus accomplished its purpose.

The third, currently active area of pervasive federal control is the present regulation of a utility company's business transactions. Before a holding company or its subsidiaries may acquire any securities, utility assets, or other interest in any business, the company must submit detailed financial information to the SEC and must obtain its

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approval. § 9(a)(1), § 10(a)(1). The SEC can refuse its approval whenever the acquisition tends toward interlocking relations or concentration of control, unduly complicates the capital structure of the holding company, or specifies consideration, including fees and commissions, which is unreasonable. § 10(b). This, in essence, gives the SEC veto power over a utility's diversification efforts which have also received any necessary approval of state regulatory commissions. This authority has impeded the efficient and economic development of utility companies under the act and has been responsible in part for turning the utility holding company industry into the backward cousin of the energy sector.

Beside these controls on external ventures, the PUHCA also provides for surveillance and regulation of internal operating practices. Section 13(a) expressly forbids a holding company from entering any sales, service, or construction contract with its subsidiaries for a charge. Subsidiaries of holding companies and mutual service companies, on the other hand, are permitted to perform such contracts for associated companies but only if the SEC determines that the charge for the work is "at cost, fairly and equitably allocated." § 13(b). This constraint does not apply to any other sector of the electric utility industry. This unduly burdens companies presently under the act. SEC regulation permeates the utility holding company business far beyond this scrutiny of individual contracts. The PUHCA also authorizes the SEC to

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regulate or, in some cases, to prohibit intercompany loans, dividend payments, capital contributions, political contributions, and lobbying activities. §§ 12(a)-(d), (h), (i).

In order to maintain this strict federal control over virtually every aspect of a holding company utility's operations, the SEC has the authority to institute numerous recording and reporting requirments that in many instances duplicate requirements of states and the Federal Energy Regulatory Commission (FERC). The SEC may prescribe the proper form and manner for keeping accounts, correspondence, memoranda, papers, and other records. §§ 15(f)-(h). The Commission also may require holding companies and mutual service companies to file annual, quarterly, and special reports on their financial condition, security structure, and assets. § 14. Together, these various requirements entangle utility operating companies in vast amounts of unnecessary and duplicative paperwork, that both FERC and State Public Service Commissions now also require.

As has been recently recognized, the time has come to evaluate whether there is a continuing need for the federal regulation of utilities established by the PUHCA. General Accounting Office, "The Force of the Public Utility Holding Company Act Has Been Greatly Reduced by Changes in the Securities and Exchange Commission's Enforcement Policies," 17 (June 20, 1977). It seems incontrovertible that the main purposes of the Act have been accomplished and that the few

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necessary remaining controls can be equally well-exercised by state utility and security commissions.

According to the GAO, the major goal of PUHCA -- simplification of holding companies' corporate structures and the confinement of the companies to specific geographic areas -- has long since been achieved. GAO Report, p. 6. See also L. Loss, Securities Regulation 2276 (2d ed. Supp. __). As a result of this process, the holding companies and their operating utilities are now amenable to effective state and local control. Given this change in reality effected by the Act, and active state agencies, it is clear that utility holding company regulation should not be duplicated with both state and federal agencies.

Secondly, in the area of securities regulation, the elaborate process of utility registration and the rules concerning insider trading and proxy solicitation afford no greater protection than the '33 Act, the '34 Act, and state securities' laws. They are essentially duplicative and can be repealed.

Thirdly, in the area of a utility's other business dealings, the state utility commisions are perfectly capable, under well-developed principles of regulatory law, to police both outside acquisitions and intrasystem transactions. State public utility commissions and FERC are competent in investigating whether a utility's acquisition of diverse businesses is likely to endanger the reliability of service,

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and these commissions are now vigilant to disallow costs charged by associated companies or any other contractor which are not in the public interest. Thus, the states are at least as capable of exercising the remaining powers granted by the PUHCA as the small staff at the SEC.

Repeal would also serve to remove disincentives to entry into the electric generating business by other industries, and to remove some restraints on joint generating projects by non-holding-company utilities.

In summary, repeal of the PUHCA would serve to free the utility industry from an unnecessary and unproductive duplicative layer of federal regulation, and to limit control of utilities' activities to the appropriate level of government: state and local utility commissions.

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IOWA RESOURCES INC.
666 Grand Avenue/P.O. Box 657
Des Moines, Iowa 50303
(515)-281-2900

Dwight H. Swanson
Chairman and President

November 18, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

Thank you for the opportunity to express our views regarding amendments to the Public Utility Holding Company Act of 1935. Iowa Resources Inc. was formed in 1979 as the holding company for Iowa Power and Light Company, an electric and gas utility serving customers in central and southwest Iowa. Iowa Resources is an exempt holding company pursuant to Section 3(a)(2) of PUHCA.

Iowa Resources favors the second approach outlined in your October 27 letter as the simpler, more beneficial approach to amending PUHCA to remove some of its unnecessary and outdated limitations on utility diversification. Specifically, it is our position that Section 3 of PUHCA should be amended, first, to exempt holding companies with only one public utility subsidiary, provided such subsidiary's operations are limited to its state of incorporation and contiguous states; second, to exempt holding companies created by companies that are presently exempt under Section 3(a)(2); and third, to remove the "unless and except" clause. Your inquiries about the impact of this approach, and our responses, are set forth below:

Question 1: To what extent, if any, would this approach lead to utility diversification?

It is our belief that adoption of the approach suggested above would substantially encourage utility diversification. Because Iowa Power operates in only one state, Iowa Resources was able to utilize the Section 3(a)(2) exemption and has established separate corporate subsidiaries for its utility and non-utility operations. However, many utilities that do not meet the current narrow exemption requirements of Section 3(a)(2) are unable to take even this first step towards diversification.

Even as an exempt holding company, Iowa Resources is hindered in its diversification efforts by the "unless and except" clause, which allows the SEC to revoke the exemption if it determines the retention of such exemption to be "detrimental to the public interest or the interest of investors or consumers." Revocation of its exemption could subject Iowa Resources to (i) the forced divestiture of either its gas or electric business; (ii) the forced sale of its non-utility businesses; and (iii)

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the additional regulation imposed upon registered holding companies of PUHCA. Removal of the "unless and except" clause and the associated limitations which have been imposed on the ability of exempt public utility holding companies and their subsidiaries to conduct businesses not functionally related to their utility operations would further encourage utility diversification.

Question 2: How would enactment affect the state public utility commission and the utility's stockholders and ratepayers? In particular, to what extent, if any, would enactment lead to diversification?

We believe that enactment of the proposed amendments will allow utilities the opportunity to diversify if business and economic conditions warrant. Diversification is only one of several strategies available to utilities as a method for improving their overall financial performance. To the extent that such improved financial performance enhances the attractiveness of its securities, a utility's ratepayers may reap long-run benefits in the form of reduced costs of capital while its stockholders benefit from increased earnings.

We are in complete support of your efforts to remove federal statutory and regulatory barriers that may inhibit the ability of utilities to financially help themselves and their stockholders and ratepayers. If I may be of further assistance in your review of the Public Utility Holding Company Act, please do not hesitate to call me.

Sincerely,

DHS/KDH/js

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ILLINOIS POWER COMPANY IP 500 SOUTH 27TH STREET, DECATUR, ILLINOIS 62525

November 19, 1981

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DAN'S NOTES

The Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Corcoran:

I am responding to your letter of October 27, 1981 to Wendell J. Kelley of our company concerning the "Public Utility Holding Company Act of 1935 - Two Legislative Approaches." We at Illinois Power are very appreciative of your keen understanding of the industry's problems and the constructive approaches you are considering for their solution. I know that representatives of the Company have expressed their thanks to you and your staff on a number of occasions. I join in this.

Of the approaches included in your discussion paper, Illinois Power Company favors Approach Two. We are taking active steps to seek an amendment of Section 3 of the Public Utility Holding Company Act of 1935 (PUHCA) for the purpose of accomplishing Approach Two. We have joined more than thirty other electric and gas utilities as an ad hoc group for this purpose. The New York and Washington law firm of Reid & Priest and an independent consulting firm have been engaged for this purpose. One of our counsel, Mr. George B. Pletsch of Schiff Hardin & Waite, is a member of the Steering Committee of this group.

One of the Group's functions is to provide historical and contemporaneous information which will answer in detail the five questions posed by Approach One and the two questions posed by Approach Two. I understand that lawyers from Reid & Priest and other representatives of the Group have had some preliminary discussions with you, or at least with members of your staff. In view of the comprehensive material which will be furnished you by our group, I will comment only briefly on the questions raised under Approach Two in your letter. Of Course, I will be happy to provide additional information if you desire.

You inquire in Question 1 under Approach Two, "To what extent, if any, would this approach lead to utility diversification?"

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The presence of the "unless and except" clause in Section 3 of the PUHCA effectively thwarts any consideration of diversification by Illinois Power Company. Diversification by it under present law would by reason of the "unless and except" clause potentially expose Illinois Power Company to the revocation of its present exemption by the SEC. The consequence of this could be not only the requirement that Illinois Power Company divest its diversified non-utility properties, but also divest one of its utility properties, a risk that the Company cannot afford to take. Therefore, in the absence of an amendment to Section 3 of the PUHCA as discussed in your letter, Illinois Power Company is effectively precluded from considering diversification.

Responding to your second question under Approach Two, the proposed amendment to Section 3 would have no effect upon the regulatory jurisdiction of the Illinois Commerce Commission. Under the Illinois Public Utilities Act, the Commission has comprehensive jurisdiction to regulate every aspect of our utility business and, in my opinion, has effectively and actively exercised that jurisdiction throughout the years.

Overall, I would expect diversification to strengthen the Company's financial performance and this would, of course, directly and indirectly benefit our ratepayers and stockholders.

I cannot say now the extent to which Illinois Power Company would diversify or in the areas in which it might diversify if the amendment is enacted. In any event, Illinois Power Company would continue to be committed to the electric and gas utility business and our obligation to render those services would always have first call on our resources. We are keenly sensitive to the needs and problems of our customers. Any diversification by Illinois Power Company would most likely be in areas allied to our present electric and gas industries.

Again, I would like to express my appreciation for your interest in our industry.

Sincerely,

Charles W. Wells

C. W. Wells
Executive Vice President

cc: Michael V. Hasten, Chairman, Illinois Commerce Commission
George B. Pletsch, Schiff Hardin & Waite
Wendell J. Kelley

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O. C. DAVIS
Chairman

Peoples Energy Corporation

122 South Michigan Avenue
Chicago, Illinois 60603
(312) 431-4600

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November 20, 1981

Honorable Tom Corcoran
House of Representatives
Washington, D. C. 20515

Dear Tom:

This response is to your request for comments concerning possible amendments to the Public Utility Holding Company Act of 1935 (the "Act") as set forth in your letter of October 27, 1981.

The Act was designed to cure perceived abuses by public utility holding company systems, primarily those of maintaining complex capital systems, issuing inaccurate and misleading financial reports and holding concentrated economic power over utility assets located in widespread geographical areas.

As we all are aware, the economic conditions and business practices of today are vastly different than those of 1935, particularly with respect to financial disclosure. With the high standards of accurate disclosures required under the Securities Act of 1933 and Securities Exchange of 1934, there is no question that deceptive practices that may have existed prior to the passage of the Act are not widespread today.

The legislative and regulatory vacuums which existed in 1935 have been effectively filled. Many of the abuses were securities and accounting problems, not unique to utility holding companies. Effective protection against the re-occurrence of such abuses which the Act was designed to eliminate exists through now mature mechanisms under the federal securities laws, the state corporation laws, the state blue sky laws, and the state public utilities acts, coupled with the strict standards which apply to the modern accounting profession.

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Given the extensive protection offered by statute or regulations other than the Act, the repeal of the Act would create no significant regulatory void. It is also important to realize the Act covers a narrow spectrum of companies. As reported in various government studies, only 14 of the 100 utility holding company systems are actually regulated under the Act. It is unlikely that a rash of state legislation would result if the Act was repealed.

The public perception of the effectiveness of the various federal and state regulatory entities is, of course, always open to subjective opinion. In Illinois, the regulation of operating public utilities by the Illinois Commerce Commission (Il.C.C.) has been diligent and pervasive. Hearings before the Il.C.C. are adversary in nature, and the utilities are required to prove that the actions which they propose to take serve the public convenience and necessity. This is not regulation by "rubber stamp"; the protection provided to the public is real.

In addition, the Illinois Public Utilities Act provides that certain transactions between public utilities and affiliated companies, such as management contracts, construction, engineering, supply, financial, purchase, sales or service agreements, are void unless approved by the Il.C.C.

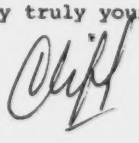
The Il.C.C. thus has the authority it needs to investigate transactions within a holding company system, which relate to an operating public utility company. Prior to enactment of the Act in 1935, intercompany transactions where not scrutinized and often created excessive charges and fictional profits.

The repeal of the Act or removal of the "unless and except" clause would not appear to have a significant effect on the authority of effectiveness of the Il.C.C. which, as stated above, is extensive. Stockholders, too, would be little affected since their main protection comes from disclosure under federal securities laws and the laws regulating business practices under the Illinois Business Corporation Act.

With respect to diversification, even if all barriers were removed by repeal or amendment of the Act diversification would only occur if the management of the utility system believed it was economically justified. It should be noted, however, that fair regulation and rates that provide an adequate return on utility assets are ultimately the best method by which utilities will continue to attract necessary capital and ratepayers will receive adequate and assured service at reasonable rates.

I appreciate the opportunity you have given us to respond to your concerns. I hope this letter will be of use to you and if there are any other questions you may have please do not hesitate to contact me.

Very truly yours,



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John V. Thornton
Senior Executive Vice President

Consolidated Edison Company of New York, Inc.
4 Irving Place New York, N.Y. 10003
Telephone (212) 460-4324

November 23, 1981

The Hon. Tom Corcoran
Representative in Congress
Congress of the United States
House of Representatives
Washington, D. C. 20515

Reference: Public Utility Holding Company Act of 1935

My dear Mr. Corcoran:

I am responding, in Mr. Luce's absence, to your letter of October 27, 1981 concerning the Public Utility Holding Company Act ("PUHCA").

Your letter requests Con Edison's views concerning two proposals relating to PUHCA, the first being repeal of PUHCA, and the second being amendments to Section 3 of PUHCA to create additional exemptions and to repeal the "unless and except" clause thereof. Your letter poses several specific questions concerning these proposals.

Before addressing your specific questions, it may be helpful to state Con Edison's general concerns with PUHCA. Con Edison is an independent, publicly-held operating utility and as such is not directly affected in its day-to-day operations by PUHCA. However, Con Edison has from time to time found it necessary to give careful and intensive consideration to PUHCA in connection with certain transactions, to ensure that the transactions did not inadvertently subject Con Edison or another party to regulation as a holding company under PUHCA. In some instances significant delay or restructuring of the transaction was necessary. Moreover, Con Edison, like many other utilities, has been examining the possibility of diversification beyond regulated utility activities, although it has not undertaken any such activities up to this time. It has become apparent to us that PUHCA may present an obstacle to utility diversification. In the light of these general considerations, and the more specific ones set forth below, Con Edison believes that a repeal of PUHCA would be desirable, but would also support an amendment to PUHCA as outlined in your letter since such an amendment would go far toward eliminating PUHCA as a barrier to utility diversification.

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Turning to your specific questions concerning repeal of PUHCA:

Question 1. We do not believe that utility companies continue to present the problems of size and structural complexity which PUHCA was intended to correct. It is generally acknowledged that one of PUHCA's primary goals -- simplification of corporate and financial structures of public utility holding companies -- has long since been accomplished. The undesirable aspects of complex corporate structures, at which PUHCA was in large part directed, are unlikely to recur in the present-day environment of full disclosure federal securities laws and comprehensive state regulation.

Question 2. We believe that the federal securities laws, the Federal Power Act, the Natural Gas Act and comprehensive state regulation would not only provide adequate protection to investors and ratepayers, but would have, if implemented in their present form, been sufficient to prevent the abuses which led to the enactment of PUHCA.

Question 3. We do not believe that the repeal of PUHCA would result in conflicting state regulation. It should be borne in mind that registered multi-state holding company systems are today subject to regulation by the multiple jurisdictions in which they operate. While such multiple regulatory jurisdictions may lead to occasional conflicts, the system appears to work reasonably well.

Question 4. While this is necessarily a subjective judgment, it is our impression that the general public seems to believe that a local or state regulatory agency will be more directly responsive to their needs and wishes than a necessarily more remote federal agency.

Question 5. In our opinion, repeal of PUHCA would leave intact a comprehensive regulatory system for public utilities in New York State. While repeal of PUHCA would eliminate a potential barrier to diversification, jurisdiction over diversification issues would continue to be held, as it is today, by the New York State legislative and regulatory authorities.

Turning to your questions concerning a proposed amendment of PUHCA:

Question 1. The proposed amendment would remove a significant potential barrier to utility diversification. However, as noted above, authority over this issue would continue to be held by the New York State legislative and regulatory agencies.

Question 2. Other than removing a potential federal barrier to diversification, the proposed amendment would have little effect on the utility industry, its regulators, stockholders or customers, in New York State.

Thank you for this opportunity to express our views on these proposals. If we can be of further assistance in your deliberations, please feel free to call upon us.

Very truly yours,

John V. Thornton

John V. Thornton
Senior Executive Vice President

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Wisconsin Electric POWER COMPANY
231 W. MICHIGAN, P.O. BOX 2046, MILWAUKEE, WI 53201

November 23, 1981

The Honorable Tom Corcoran
Representative in Congress
1107 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Representative Corcoran:

In reply to your letter of October 27, 1981, I appreciate the opportunity to express the position of Wisconsin Electric Power Company with respect to potential proposals to repeal or to amend significantly the provisions of the Public Utility Holding Company Act of 1935. I note with encouragement your interest in removal of federal barriers that may inhibit the ability of utilities to financially help themselves and their stockholders and ratepayers.

Before I respond to the specific questions raised in the attachment to your letter of October 27, I should emphasize that Wisconsin Electric is, as you note in your letter, a holding company exempt from the Holding Company Act by order of the Securities and Exchange Commission. The result of the exemption (which has been in effect for more than a quarter century) is that our ongoing activities are not and have for a long time not been directly impacted by the restrictions in PUHCA. On the other hand, however, PUHCA has had an adverse effect upon managerial decisions of an organizational nature. For example, some years ago we had determined that some financial advantages could be obtained by organization of a new subsidiary to own a power plant we were about to build. Ultimately, we decided that the power plant should be owned directly by Wisconsin Electric. In large part, the reason for the decision was the opinion of counsel that a new public utility subsidiary in our corporate structure would result in loss of our exempt status under the PUHCA. It was our reluctant conclusion that the financial benefits of the contemplated organization would have been cancelled out by the regulatory costs and complications of registration under PUHCA.

Turning now to your specific questions:

APPROACH ONE: Repeal the PUHCA with provisions stating that such repeal would not affect any PUHCA proceedings previously commenced.

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Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct? Please specify?

The circumstances of the gas and electric utility industry today bear little resemblance to those in the 1920's and early 1930's which led to enactment of PUHCA along with many other federal and state statutes. Most of the utility industry nationwide was then under the control of a small number of holding company systems. State and local regulatory bodies had, in most states, neither the resources nor the legal authority for effective regulation of these complex interstate holding company systems. The picture has changed radically in the past nearly half-century both in terms of the sophistication and powers of the state and federal regulatory authorities and in terms of the composition of the utility industry itself. Even leaving PUHCA aside entirely, there has been in place for decades a pervasive state and federal regulatory aggregate which exercises effective control in the public interest over virtually every aspect of a utility's business (insofar as it relates to the provision of and charges for utility service) whether the utility is local or interstate and whether it is independent or a part of a holding company system. In short, times have definitely changed.

Question 2: To what extent would federal and state law adequately protect the interests of stockholders and ratepayers were PUHCA to be repealed?

In my view, and in the circumstances of Wisconsin Electric Power Company, the pervasive state and federal laws now in place (including, for example, state and federal antitrust and securities laws) provide entirely adequate protection for stockholders and ratepayers and would not, in my judgment, be any less effective in doing so were PUHCA to be repealed.

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

In the case of an exempt holding company, I do not see that repeal of PUHCA would result in any conflicting state regulation beyond that which exists even now. The case of the registered holding companies might, however, be different in this respect, but I do not presume to answer in their behalf.

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

Since state regulatory bodies have the unpleasant task of making necessary, but unpopular, decisions with respect to highly controversial matters, it is not surprising that they are frequently the targets of political opportunism and irresponsible news media

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treatment. Inevitably, this kind of unrelenting pressure will tend to have an effect upon public confidence. But the remedy for this sort of thing does not, in my judgment, reside in transferring politically sensitive decisions involving essentially local matters to Washington or retaining them there. To answer your question more directly, I do believe that the public in Wisconsin has enough confidence in the state public service commission to reduce the federal role in regulation of local utilities.

Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

Because Wisconsin Electric Power Company is, as noted several times above, an exempt utility under PUHCA, repeal of the Act would, I believe, have minimal effects on ordinary, ongoing utility activities. What repeal would do, though, is to remove the artificial and arbitrary constraints PUHCA places on our Company's ability to organize itself in the most effective way. With respect to possible diversification, it is my judgment that repeal of PUHCA would have no effect whatever on our circumstances. We believe that it is possible for us under present law to obtain the necessary approval of the Securities and Exchange Commission under PUHCA for a reasonable amount of diversification and to remain an exempt system. In fact, we have an application presently pending with the SEC for such approval. In our particular case, however, the state Public Service Commission has decided that its approval is also required for diversification. That Commission has determined that it will initiate a rulemaking proceeding to set out the criteria for obtaining such approval and to announce the conditions upon which such approval might be given. This course of action by our state Commission makes somewhat academic in Wisconsin the whole question of change or repeal of PUHCA.

APPROACH TWO: Amend Section 3 of PUHCA, first, to exempt holding companies with only one public utility subsidiary, provided such subsidiary's operations are limited to its state of incorporation and contiguous states; second, to exempt holding companies created by companies that are presently exempt under Section 3(a)(2) of the Act; and, third, to remove the "unless and except" clause.

Question 1: To what extent, if any, would this approach lead to utility diversification?

For the reasons stated above, we believe that we can qualify under present law for SEC approval of our proposed restructuring for the purpose of diversifying. For this reason, repeal or amendment of PUHCA would not in itself lead to diversification in our case. Nevertheless, repeal of the Act or, at least, elimination of the "unless and except" clause would have the effect of eliminating unnecessary and arbitrary restrictions (particularly

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related to the degree of diversification) which would otherwise exist and which would have the effect of impeding the total operation's potential for success.

We assume that the proposed amendment of PUHCA as outlined in APPROACH 2 would involve the creation of additional exemptions, leaving the existing exemptions contained in Section 3 unchanged. If APPROACH 2 would change the Section 3(a)(1) exemption, it would create some difficulties for Wisconsin Electric. By limiting the Section 3(a)(1) exemption to holding companies with only one public utility subsidiary, you would make it unavailable to Wisconsin Electric, which already has (and has had for many years) another public utility, Wisconsin Natural Gas Company, as its own subsidiary, which utility would, under our restructuring approach, be a separate subsidiary of a new holding company. Further, there may, depending on the exact language of the amendment, be some difficulties for Wisconsin Electric in connection with your Section 3(a)(2) revision. Wisconsin Electric is presently exempt under Section 3(a)(2), since it is "predominantly a public utility." Recently, discussions were held with the management of a financially troubled public utility in the state of Michigan concerning its possible acquisition by Wisconsin Electric. Acquisition of that company (which would have been approved by state regulatory authorities in Wisconsin and Michigan only if determined to be in the public interest) as a subsidiary would have raised a question as to whether the Section 3(a)(2) exemption could continue for Wisconsin Electric. The alternatives would have created an unacceptable situation in which our present utility customers might have been required to subsidize the utility rates of the customers of the acquired system. Maintenance of the separate corporate status of that utility would have made it more likely that equity among the customers could be maintained and would have simplified the actual process of acquisition. Our decision not to proceed with the acquisition was principally based on economic grounds but was affected by the regulatory complications under PUHCA. Your revision to Section 3(a)(2) would not have helped.

Question 2: In your opinion, how would enactment affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would enactment lead to diversification?

Because our state Public Service Commission has decided to assert jurisdiction over utility diversification, repeal or amendment of PUHCA in the manner you describe would probably not have any significant local effect. Further, for the reasons I stated above, repeal or amendment of PUHCA would probably not have any significant effects upon Wisconsin Electric's potential for diversification.

* * *

Again, I thank you for the opportunity to express Wisconsin Electric's position on this matter. If you wish any further information, please contact me directly or, if you prefer, you may contact Mr. Nicholas A. Ricci, Senior Vice President, who is in charge of our strategic planning group.

Very truly yours,

C. S. McNeer

President

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CONSOLIDATED NATURAL GAS COMPANY
Four Gateway Center
Pittsburgh, Pennsylvania 15222

G. J. TANKERSLEY
Chairman

November 23, 1981

The Honorable Tom Corcoran
The United States House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Corcoran:

This is to acknowledge your letter of October 27, 1981.

I support your expressed desire to remove federal statutory and regulatory barriers which inhibit a utility's ability to improve its financial status, and welcome this opportunity to comment specifically on the Public Utility Holding Company Act of 1935 (the 1935 Act).

The objectives of the 1935 Act are now met by a combination of State and Federal acts and regulations. The 1935 Act is therefore duplicative and its continuation serves no useful purpose. In addition, it places undesirable restrictions upon both the timing and methods of financing of regulated companies and limits the ability of such companies to diversify into non-regulated energy-based endeavors in furtherance of their long-range corporate goals. Maximum flexibility to expand the energy-related activities of our company is essential to its financial health.

I also stress the need for Congress to recognize the fundamental differences between the electric utility industry and the natural gas industry (see answer to question 5), because of which a sound solution for one industry may be inappropriate for the other.

I attach answers to the seven questions raised by your letter. If I can provide additional information, please let me know.

Respectfully submitted,

G. J. Tankersley

Attachment

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PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Two Legislative Approaches

Approach One: Repeal the PUHCA with provisions stating that such repeal would not affect any PUHCA proceedings previously commenced.

Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct? Please specify.

None. Since 1935 many companies have reorganized so that they are no longer public utility holding companies. Other companies have reorganized to confine their organizations to a single state so that they are exempt from the Act's regulation. Today only 13 companies, including three gas holding companies, are subject to the Act. The task assigned to the Securities and Exchange Commission of dismantling and reconstructing the mammoth utility systems of the twenties is completed.

Even if the Act is repealed, it would be virtually impossible for a public utility holding company desiring to implement a financial structure like that which Congress found abhorent in 1935 to find a public market for its securities. The rating services (if the issue were debt or preferred stock) would give it unacceptable ratings, sizable investment banking firms would shun the offerings and the analyst community would quickly expose the dangers inherent in such financial structures. In effect, the market would provide the necessary discipline to assure that improper and dangerous financial practices were not engaged in.

Question 2: To what extent would federal and state law adequately protect the interest of stockholders and ratepayers were PUHCA to be repealed?

A detailed examination by a major law firm[1/] clearly demonstrates that other federal and state legislation[2/] duplicates the PUHCA and that the interest of stockholders and rate payers would be adequately protected even if the PUHCA were repealed.

In summary, the primary abuses of which utility holding companies were guilty prior to the PUHCA included undesirable accounting practices, the issuance of securities on the basis of arbitrary markups of asset values, and the creation of paper profits through transactions between affiliated corporations. Each of these abuses is proscribed by existing statutes and regulations other than PUHCA.

1/ Morgan, Lewis & Bockius of Washington, D.C.

2/ While the detailed examination of state law was limited to New York, Ohio, Pennsylvania and West Virginia, it is believed that most, if not all, other states have basically similar statutes.

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1. Undesirable Accounting Practices

Undesirable accounting practices are a thing of the past. Under the Public Utility Holding Company Act of 1935 (the 1935 Act), the SEC has imposed a uniform system of accounts on registered companies. However, under the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act), the SEC has very broad power to establish standards for the form and content of financial statements. The SEC has exercised that power through Regulation S-X and 300 Accounting Series Releases. Moreover, since 1935, the states and the Federal government have adopted uniform systems of accounts for public utility companies pursuant to authority granted by other statutes.

In 1935, these accounting principles barely existed. The American Institute of Accountants now the American Institute of Certified Public Accountants (AICPA) was first established in 1932 and did not estalish its Committee to issue statements on accounting principles until 1935. Since then, under the stimulus of the SEC, the demands of investors, and of Congress, the accounting profession has established an elaborate mechanism for the development of accounting principles and effective means of compelling their use. All of the registered public utility holding companies are already required to file with the SEC and send to their shareholders financial statements reviewed by independent public accountants. If those statements are prepared in accord with Financial Accounting Standards Board (FASB) principles, they are viewed as having authoritative support. The FASB and its predecessor, the Accounting Principles Board, have introduced into accounting a high measure of uniformity.

The Foreign Corrupt Practices Act adopted in 1977 and the implementing rules adopted by the SEC also prohibit the falsification of books and records and mandate the maintenance of satisfactory internal accounting controls. Under prevailing principles, assets must be carried on financial statements at their historical cost and amortization or depreciation must be based on those values.

In 1935, the SEC had not developed the concept of its authority to so discipline professionals and the disciplinary mechanism of the accounting profession was not well developed. Both are now.

2. Fraudulent Issuance of Securities

Similarly, remedies for the fraudulent issuance of securities are provided for under other statutes. All public utility holding companies presently registered under the 1935 Act are also registered under the 1934 Act which requires continuous disclosure by subject companies. All such companies are also subject to the 1933 Act when making a public distribution of securities. The disclosure concepts in the 1933 and 1934 Acts had been little developed when the 1935 Act was adopted. Since that time, however, these concepts have been extensively developed, with the result that they impose upon companies extensive disclosure requirements far beyond anything foreseen in 1935. Extensive financial statements are required to be disclosed both in connection with offerings and on a continuous basis, as is information concerning the nature of the company's

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business, its properties, its management, and its capitalization. Were the 1935 Act to be eliminated, there would be virtually no change in the amounts or types of information which would have to be disclosed to the public by public utility holding companies.

3. Transactions with Affiliates

The opportunity to create the illusion of profit by transactions between affiliates also would remain adequately regulated. In 1935, transactions between affiliates were not regulated by state authorities. Today, state commissions generally have this power.

Under Regulation S-X (which must be followed for all 1933 and 1934 Act filings) significant transactions between "related parties" must be disclosed in footnotes to the financial statements. The term "related party" is defined to include a party with the ability to significantly influence the management or operating policies to the extent that the company might be prevented from pursuing its own interests.

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

No. The states would retain their existing jurisdiction.

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

The public is not generally aware of any federal role in regulation of local utilities.

Public perception of state PUCs varies with consumers' subjective impressions of retail rates - which is not within the purview of the PUHCA.

Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

The jurisdiction of the state PUCs would not be expanded beyond regulation of the local utility and of transactions between the local utility and its affiliates. The state PUCs should not have authority to regulate non-utility activities of affiliates which do not directly involve the local utilities.

Repeal of the PUHCA would eliminate the necessity of obtaining approval of the SEC as well as the state PUCs for intrasystem financing of day-to-day utility operations. Currently, such financings require approval of both commissions, and the SEC is asking for a minimum of 60 days in which to process an application.

Regulation of affiliate transactions by local PUCs should effectively prevent any adverse effect of repeal of the PUHCA. There should be no drain on

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utility assets which, in turn, will prevent utilities from subsidizing nonutility activities. Correspondingly, repeal should inhibit the abusive practice of some state commissions which have repeatedly denied adequate rates to holding company subsidiaries under their jurisdiction, compelling a diversion of earnings from other states or activities to subsidize that utility's operation.

Repeal should have no effect upon utility rates except an anticipated decrease in the cost of capital resulting from increased flexibility in financing. Stockholders should benefit from repeal and the diversification which would be expected to result.

Utility returns are diminishing, and as gas costs increase, more and more incentive will be created to keep costs to consumers low by keeping the return on equity down. If a gas utility is forced to stay strictly limited to gas distribution, the result could be an unmarketable gas company stock. Through diversification, a company may have an opportunity to broaden the investment attractiveness of its stock and to provide better for the future needs of its customers.

The fundamental differences in the basic nature and operations of the remaining registered electric and gas public utility holding companies should also be recognized. These differences include:

(1) Some electric holding companies don't wish to be exempt.

(2) The three gas holding companies still under the Act are substantially localized in the Northeast[1/] which is projected to be a no-growth region -- the electrics under the Act serve throughout the nation.

(3) Gas is a finite resource.

(4) There are no giant appliance manufacturers such as General Electric (a) doing research on new gas appliances, or (b) with such mass marketing capabilities.

(5) There are a limited number of uses for gas, particularly in the residential market, as compared with relatively unlimited electric uses.

Approach Two: Amend Section 3 of PUHCA, first, to exempt holding companies with only one public utility subsidiary, provided such subsidiary's operations are limited to its state of incorporation and contiguous states; second, to exempt

1/ Consolidated Natural Gas Company, Columbia Gas Company, Inc. and National Fuel Gas Company all serve Ohio, Pennsylvania and New York. Consolidated and Columbia serve West Virginia and Columbia also serves Virginia, Maryland and Kentucky.

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holding companies created by companies that are presently exempt under Section 3(a)(2) of the Act; and, third, to remove the "unless and except" clause.

Question 1: To what extent, if any, would this approach lead to utility diversification?

Question 2: In your opinion, how would enactment affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would enactment lead to diversification?

This approach would not be meaningful to two of the three existing gas holding companies subject to the 1935 Act since they have a number of utility subsidiaries, each incorporated in its state of operations. For a single utility to operate in more than one state often entails incorporation in each state and in all cases would involve a degree of overlapping state regulation. In short, this approach would subject multi-state utility operations to the regulation of all states in which the utility operated. It would be far preferable to allow more than one public utility subsidiary so long as each such subsidiary's operations are regulated by the state of operation.

11/23/81

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Eastern

Eastern Gas and Fuel Associates
One Beacon Street
Boston, Massachusetts 02108
(617) 742-9200

November 23, 1981

DATE ANS: W. J. PDQO #:
AIDE President REC #:
CATS
PARA:
DATE IN:
FILL INS: NOV 24 [redacted]
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DAN'S NOTES

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

This is to acknowledge receipt of your letter dated October 27, 1981 concerning possible legislation affecting the Public Utility Holding Company Act of 1935.

You are aware, I am sure, that Eastern Gas and Fuel Associates is an exempt holding company under §3(a)(1) of the statute, the so-called intrastate exemption. We are not unhappy with the status quo. We have found the staff of the Securities and Exchange Commission to be cooperative and reasonable, and I do think that those who advocate outright repeal of the statute carry a heavy burden of demonstrating that the old evils of pyramiding and geographical dispersion would not recur. Clearly none of the disclosure provisions of the other statutes administered by the Securities and Exchange Commission would be a substitute for §§6, 7, 9 and 10 of the Public Utility Holding Company Act, which regulate sales and purchases with a view to preventing a return of the evils that the geographical integration and corporate simplification provisions of §11 of that Act were designed to cure.

It occurs to me also that there is really nothing in the Holding Company Act to prevent diversification of electric or gas companies as long as they do not create public utility holding companies. That is to say, an electric or gas operating company is free, so far as the Holding Company Act is concerned, to organize as many non-utility subsidiaries as it likes. The catch is that the state utility commissions might well have something to say in that event. In other words, the real impediments to diversification come from state law, not federal. Thus, what the proponents of repeal really want, it might be argued, is to be free of any control, whether federal or state, so far as diversification is concerned. Whatever the merits of diversification, further thought must be given to the relative safety, particularly in view of the background of abuses that produced the Holding Company Act, of permitting unchecked diversification.

I appreciate this opportunity to express our views.

Sincerely,

William J. Pruyn

WJP:sec

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W R Berls
Executive Vice President - Finance

General Offices: 212 West Michigan Avenue, Jackson, MI 49201 • (517) 788-1111

November 24, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, DC 20515

Dear Congressman Corcoran:

By letter dated October 27 you advised of your concern with the financial condition of the utility industry, and specifically addressed the matter of possible repeal or amendments to the Public Utility Holding Company Act of 1935.

The first approach postulated in your letter is total repeal of PUHCA, an action which we do not believe is needed in view of Approach Two, which is a more limited amendment of the Act.

Specifically, utility companies do not today present the problems of size and complexity which the original act was intended to correct. According to investigative reports which led to the adoption of the Act, several large holding companies had literally hundreds of subsidiaries, with a pyramidal structure which resulted in highly leveraged companies, often with a minimal equity investment, controlling billions of dollars of assets and revenues. Allegedly, this also led to securities price manipulation, utility plant cost write-ups and inaccurate or misleading accounting methods. The present level of both Federal and State regulatory and reporting mechanisms make it virtually impossible for any of the alleged past abuses to go undetected or uncorrected. Since the passage of the Act, state public service commissions have grown in size and sophistication so that the public has more confidence in state regulation than it does in an agency remotely located in Washington. Repeal of the Act would encourage diversification for reasons listed under Approach Two and, if such diversification were properly undertaken into unregulated businesses, could provide sources of revenues which enhance the financial strength of the overall enterprise. This in turn would enhance credit worthiness, securities ratings of the parent company and result in lower securities costs and, therefore, reduce the upward impact on ratepayers costs. Likewise, it would moderate the impact on stockholders of the dilution caused by issuance of new equity securities.

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With respect to Approach Two, which is favored by this Company, similar opportunities would be presented for diversification, but more closely to what most utilities want to be permitted to do. It would permit a holding company to be created to own and operate separate areas of utility and nonutility functions, thus permitting clearly identifiable accounting of investment and costs for each of the activity areas. By such a separation, the benefits of successful nonregulated diversification could benefit the stockholder of the parent and reflect improved market price and stronger possibility of regular dividend increases. Improved market price of the parent's common stock would again reduce the dilution impact of new securities sales.

Our Company is a combination electric and gas company and, to us, the elimination of the "unless and except" clause is of paramount importance in order not to be faced with a forced divestiture. Further, as costs of generating facilities continue to escalate, the benefits of joint equity ownership among several electric companies of major generating subsidiaries would spread cost and risk to more manageable size. Any efforts to diversify, either for enhancement of financial stability or spread of risk, is inhibited by the threat of revocation of exemption by the "unless and except" provisions.

We strongly favor Approach Two as a reasonable amendment which would enhance prudent diversification for the benefit of the companies, their stockholders and ratepayers.

Very truly yours,

W R Boris
Executive Vice President - Finance

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Public Service
Electric and Gas
Company

Robert L. Smith
Chairman of the Board

80 Park Plaza, Newark, NJ 07101 201 430-5656 Mailing Address: P.O. Box 570, Newark, NJ 07101

November 24, 1981

Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D. C. 20515

Dear Congressman Corcoran:

As indicated in your letter to me of October 27, 1981, there is concern about the financial plight of the utility industry. We wholeheartedly support your interest in removing Federal statutory and regulatory barriers that may inhibit the ability of utilities to financially help themselves, their stockholders and rate payers. We further agree that changes to the Public Utility Holding Company Act of 1935 would provide some relief.

As a result, we are presently participating with a group of other public utilities which is seeking to amend Section 3 of the Public Utility Holding Company Act along the lines of your "Approach Two" with the hope that such a limited change can be adopted expeditiously. We also feel that repeal of the Act ("Approach One" in your letter) would provide the maximum benefit for utilities, but we are concerned that the legislative process involved in repeal could be an extended one. To the extent that relief is delayed, of course, the benefits are more tenuous. We therefore favor "Approach Two" included with your letter, for help in the near term. We would hope, however, that Congress would ultimately repeal the Act.

In specific response to your discussion paper, we believe that under Approach One, Questions 1 and 2, utility companies do not presently present the problems of size and structural complexity the Act was designed to correct. As a result of the Act, various divestiture proceedings were carried out by the Securities and Exchange Commission, resulting in the desired simplification. Moreover, the Securities Act of 1933 and the Securities Exchange Act of 1934, also administered by the SEC, have proved to be far more effective regulatory tools than originally perceived at the time of their adoption. Therefore, the complexities of structure and abuses designed to be remedied by the Holding Company Act could not exist today in the form or manner in which they were present back in 1935. The full disclosure provisions of the Securities Act and the continuous reporting requirements of the Exchange Act are sufficient Federal regulatory tools to assure

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that the purposes of the Public Utility Holding Company Act continue to be followed and that investors and shareholders are adequately informed as to the financial condition and operations of public utilities. Further, present day state regulation of utilties exists to the extent that a comprehensive Federal regulatory scheme is no longer required.

With respect to your Questions 3 and 4 under Approach One, repeal of the Holding Company Act would not result in any conflicting State regulation with respect to this Company, since our retail operations are wholly within New Jersey. Also, since this Company is not presently a holding company, repeal of the Act would not affect our regulation as it presently exists. However, it would permit the Company to diversify through a holding company without the fear of an SEC required divestiture of the electric business from the gas business or of subsidiary operations which are not "functionally related" to utility operations. We believe that repeal of the Holding Company Act would lead to diversification in the utility industry and that by broadening the operations of utility companies stockholders could be provided a better investment, without detriment to utility rate payers.

We also believe that under Approach Two, utility diversification would result. Again, such enactment would not affect our State public utility regulation, and any resulting diversification would not have an adverse effect on our rate payers but could enhance our stockholders' investment.

We hope our responses will be helpful in your effort to reduce the Federal regulatory burden on public utilities. If we can be of any further assistance, please do not hesitate to contact me or John F. McDonald, our Senior Vice President - Governmental Affairs.

Sincerely,

Robert L. Smith

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MONTANA POWER COMPANY mpc GENERAL OFFICES 40 EAST BROADWAY BUTTE MONTANA 59701 • TELEPHONE 406/723 5421

JOSEPH A. McELWAIN
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER

November 24, 1981

Hon. Tom Corcoran
House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

Your request for a response to two possible legislative approaches to the Public Utility Holding Company Act of 1935 (PUHCA) is somewhat challenging for The Montana Power Company (the Company) to answer, for reasons which appear below.

The Company is not a holding company under PUHCA at present, but it is highly diversified through ownership of a number of subsidiaries. This diversification is primarily confined to energy-related activities in coal, oil, and natural gas in Canada, Montana, Wyoming and Texas. Expansion of these activities to other states is in contemplation. Additionally, generally as an incident to other operations, the Company has established such things as an aircraft sales, service and charter business, a shopping center, an industrial park, and a small water and sewer utility, all in Montana.

We are, therefore, facing the PUHCA from a somewhat different aspect than companies seeking to diversify. We are diversified, and are seeking the appropriate structure for that diversity. The PUHCA has features which cause us real concern, as will appear below. However, we have not advocated or suggested repeal of PUHCA, your Approach One, because it goes beyond our needs. In that context, then, we respond to the questionnaire.

APPROACH ONE: Repeal of the PUHCA.

Question 1. In my experience utility companies generally do not present problems of size and undue structural complexity. This

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Company is, perhaps, complex, but in a functional way and for good business reasons. For example, our coal subsidiary, Western Energy Company, itself has a subsidiary, Northwestern Resources Co. But that subsidiary was created solely because the corporate name of Western Energy was not available for use in Wyoming and Texas, where we have coal and lignite properties. Canadian-Montana Pipeline Company is a separate corporation, chartered by the Parliament of Canada, because Canadian law requires it to have that status. Other examples could be given from our corporate complex.

Question 2. If the PUHCA were repealed, there would still remain a substantial system of checks upon corporate behavior in other laws administered by the SEC, plus conditions of the Federal Power Act, the Natural Gas Act, and disclosures and reporting under those acts, plus state regulatory controls.

Question 3. I cannot predict whether repeal of PUHCA would result in conflicting state regulation. It is, of course, possible, but whether states would be anxious to assume the added costs of regulation may be doubtful.

Question 4. In Montana, the PSC is elected, and presumably the voters have confidence in those they elect. Here, I think the PSC is perceived by the public as having the premier role in utility regulation, with the federal role less clearly perceived.

Question 5. In my opinion, repeal of PUHCA would not, in and of itself, have any effects upon our PUC, shareholders or ratepayers beyond what we believe to be the beneficial effects achievable under your Approach Two. Repeal, like amendment, would facilitate a more appropriate organizational structure for the Company.

APPROACH TWO: Amend the PUHCA in the Manner Described.

Question 1. This Company's situation precludes me from answering for this Company, because it is diversified and for other companies, because I do not know. Montana Power is a diverse company in search of a proper structure, not a company searching for a proper structure so that it may diversify. But, if it were not diversified, it would not look to the Act in its present form as an aid in doing so, and for these reasons.

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(A) The Montana Power Company is a combination company, providing electric, gas (and, through a subsidiary, water and sewer) service. The bias of the Act against combination companies is a formidable deterrent, because of the prospect of forced divesture of either the electric or the gas business, should the full weight of the PUHCA fall on us.

(B) The Pacific Lighting case suggests the danger that divesture of non-utility businesses not "functionally related" to the main remaining business might also be stripped away, absent repeal of the "unless and except" clause of the Act.

(C) This Company could not function in its present activities were it found not to be exempt, by virtue of the "unless and except" clause of the present act.

Question 2. Enactment of the amendments, which I most strongly favor, would not enhance our diversification, but would make it possible to conduct business within an appropriate structure. The effect upon ratepayers is that they would be subject only to clearly identified utility assets and operations upon which utility earnings would depend; upon stockholders, that they would enjoy fully the benefits (and suffer fully the risks) of investments from retained earnings; upon the state PUC, no enlargement or diminution of authority or jurisdiction, and hence, no real effect.

I would expect a generally beneficial effect from diversification. The ventures we have formed have been profitable, by and large. In 1980, for example, non-utility income after taxes and interest was $19,249,000, out of a consolidated net income for all utility and non-utility operations of $43,077,000. This suggests that in our case, diversification has been healthy, and certainly supportive of the overall condition of the Company and its subsidiaries.

Very truly yours,

Joe McIlwain

J. A. McIlwain

JAM/WJC/pb

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C. J. Gauthier
Chairman and President

NICOR

The Basic Energy Company P.O. Box 200 Naperville, Illinois 60540 Phone 312 242 4470

November 24, 1981

The Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Tom:

Thank you for your October 27 letter with the attached questionnaire concerning two legislative approaches to repeal or amend the Public Utility Holding Company Act of 1935 (the "1935 Act"). NICOR Inc., an Illinois corporation, is, as you point out, an exempt public utility holding company under the provisions of Section 3(a)(1) of the 1935 Act. Its sole public utility subsidiary is Northern Illinois Gas Company, an Illinois corporation regulated by the Illinois Commerce Commission and serving over 1.4 million customers in northern Illinois generally outside the City of Chicago.

NICOR's non-utility subsidiaries presently contribute approximately 38% of our net income; as our non-utility business expands, this percentage will increase significantly. Our non-utility subsidiaries are engaged in oil and gas exploration and production, contract drilling for oil and gas operators, barging and offshore oil field supply services on the inland and gulf coast waterways and coal mining. We believe this energy-related diversification is in the best interest of our stockholders and that it has also benefitted the customers served by NI-Gas; for example, our gas exploration and production activities have added to the domestic supply of natural gas.

NICOR was formed in 1976 as the holding company for NI-Gas and other energy-related business. The restructuring of NI-Gas to form NICOR was approved by the Illinois Commerce Commission.

Either of the two legislative approaches mentioned in your letter, would be salutory, in that needless regulation would be eliminated. Because NICOR is an exempt holding company, "Approach Two", which calls for amendments to section 3 of the 1935 Act, would be most closely tailored to our interests. In response to the specific questions under Approach Two:

1. Because NICOR has only one public utility subsidiary, NI-Gas, whose operations are limited to the State of Illinois where both NICOR and NI-Gas are incorporated, the first proposed amendment would exempt NICOR from all restrictions under the 1935 Act. This would mean that the good business judgment of our management, rather than the views (however well-meaning) of the staff of the SEC, would determine the extent to which NICOR could diversify its non-utility activities.

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The second proposed amendment, to provide an exemption for holding companies formed by companies presently exempt under section 3(a)(2) of the 1935 Act would have been beneficial to NI-Gas at a prior time in its history, but would have no direct effect on us now.

The third proposed amendment removing the "unless and except" clause from section 3(a) would eliminate the opportunity of the SEC staff to engage in "jawboning" regulation whereby certain policies applicable under the 1935 Act to registered holding companies have been applied, without any specific statutory mandate, to exempt holding companies. This amendment would be particularly important if the first and second amendments were not adopted, because there would otherwise continue to be informal regulation of diversification by the SEC staff under the 1935 Act.

The result of the proposed amendments would be to place the responsibility for diversification programs squarely where it belongs -- with the management of the holding companies. NICOR's freedom to pursue further diversification would then be as extensive as the freedom of other holding companies, such as those with pipeline or railroad subsidiaries and those whose subsidiaries are not in any regulated business. Removing the present discrimination against exempt public utility holding companies would allow them to enter a wider variety of businesses, where it appeared that such entry would benefit the holding company and its several "publics".

Although NICOR has not yet been required by the present regulation of exempt holding companies to forego diversification plans it otherwise would have followed, the existence of the regulatory scheme probably does have a somewhat limiting effect on our approach to diversification. We believe the interests of our stockholders, employes and customers would be well-served if we were free of such artificial restrictions. In general, such freedom would probably lead to somewhat more extensive diversification by exempt holding companies.

2. Approach Two would not affect the Illinois Commerce Commission, which regulates NI-Gas, but does not regulate NICOR. Nor would it affect NI-Gas or its ratepayers because state regulation of the utility would continue unimpaired. The stockholders of NICOR would benefit for the reasons described in the answer to question 1, and they would benefit from the savings which accrue when any needless regulatory burden is lifted.

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My responses to the specific questions under Approach One will be summary although I would be pleased to expand upon them if you wanted me to:

1. In my opinion, utility companies and systems have long since ceased presenting the problems of size and complexity that the 1935 Act was intended to control. Certainly, the officers and directors of these companies have learned much from the economic collapse that led to passage of many remedial statutes, including the 1935 Act. The mistakes of that earlier era are not likely to be repeated.

2. Regulation of utility companies by state commissions, and in some cases by the FERC under the Federal Power Act and the Natural Gas Act, would adequately protect the interests of utility ratepayers. The interests of stockholders are adequately protected by the Securities Act of 1933, the Securities Exchange Act of 1934 and more vigorous enforcement of state securities laws.

3. I am not aware of any reason for repeal of the 1935 Act to result in conflicts with state regulation of intrastate utilities.

4. I believe that the public has increasing confidence in state solutions to problems as opposed to seeking answers to all problems from the Federal government. The poor experience with Federal intrusion on state regulation brought about by the Natural Gas Policy Act of 1978 demonstrates that Federal regulation is often disruptive and inefficient. As you know better than I, Congress is becoming more aware of this.

5. I answered this question above under Approach Two.

I thank you for taking a serious interest in this important subject. If I can be of any help to you, please let me know.

Sincerely yours,

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NICOR

C.J. Gauthier
Chairman and President

P.O. Box 200
Naperville, Illinois 60566
Phone 312 242 4470

January 6, 1982

The Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Tom:

Thank you for your letter of December 23, 1981 enclosing a copy of H.R. 5220 which you recently introduced. It appears that H.R. 5220 follows Approach Two in the questionnaire of October 27, 1981 and my comments are set forth in my November 24th letter to you.

Incidentally, the list of respondents you mentioned was not included with your letter. If it is still available, we would appreciate a copy.

Sincerely yours,

Joe

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DUKE POWER COMPANY
P. O. Box 33189
CHARLOTTE, N. C. 28242

November 25, 1981

WILLIAM S. LEE
PRESIDENT &
CHIEF OPERATING OFFICER
704-373-4083

The Honorable Tom Corcoran
Member of Congress
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Congressman Corcoran:

This is in response to the discussion paper relating to the Public Utility Holding Company Act of 1935 (PUHCA), which was enclosed in your letter of October 27, 1981. We at Duke Power Company appreciate the opportunity to comment on the possibility of removing the federal statutory and regulatory barriers to electric utility diversification which are contained in the PUHCA.

The serious financial condition of the electric utility industry is now widely recognized, and the resulting threat to the nation's long-range electric power supply can no longer be seriously questioned. The ultimate solution to the problem lies in a reformation of the regulatory process so as to afford electric utilities an opportunity to earn a competitive return on investment. At the same time, electric utilities must explore other opportunities to improve earnings and to make their securities more attractive in the marketplace. One such opportunity may be diversification.

The PUHCA, in our view, unnecessarily restricts utility diversification. While strict limitations on diversification may have been necessary in the public interest in 1935 because of abuses which existed in the electric utility industry, we do not believe that they are required today. State laws and regulations, for example, are far stronger and more pervasive than in 1935 and afford substantial protection against the potential for holding company abuses. Moreover, the disclosure provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 afford far more protection against such abuses than was contemplated when these statues were enacted. The potential for "pyramiding" and accounting irregularities, which prompted the

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enactment of PUHCA, simply do not exist today because of the structure of the utility industry and the uniform system of accounts which is mandated and administered by the Federal Energy Regulatory Commission.

Duke Power Company prefers the second of the two approaches outlined in your discussion paper. "Approach One" encourages diversification, but may be too far-reaching to receive widespread public acceptance. "Approach Two" makes only limited changes in PUHCA, but it, too, would encourage diversification. It would provide for two additional exemptions to PUHCA and, most importantly, would eliminate the "unless and except" clause which makes all exemptions conditional. Exempt holding companies are presently discouraged from diversifying because under the "unless and except" clause a company may be subject to forced divestiture of either its utility or non-utility business. It may also be subject to the additional regulation imposed by PUHCA upon registered holding companies, including the prohibition against diversification into non-functionally related areas, simply upon a finding by the SEC that such is in the public interest.

In summary, "Approach Two" would encourage diversification, but would leave intact regulation of the registered holding companies. As we have indicated, diversification could benefit overall financial performance and, to the extent that diversifiation is successful, it could provide indirect benefits to customers as well as direct benefits to shareholders.

We appreciate very much the opportunity to make these comments.

Sincerely yours,

W. S. Lee

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Atlantic Electric
SERVING A MILLION PEOPLE
IN SOUTHERN NEW JERSEY

Jerrold L. Jacobs
Senior Vice President - Finance

LAW'S NOTES af

November 25, 1981

Honorable Tom Corcoran
Representative in Congress
Congress of the United States
House of Representatives
Washington, D. C. 20515

Dear Congressman Corcoran:

In a recent letter to our Company, you proposed two potential legislative approaches to the modification of the Public Utility Holding Company Act of 1935.

We attach for your use comments of the Atlantic City Electric Company with regard to your position paper. We hope these comments prove useful to you in any future modification of the Act.

If we can be of any further assistance to you in this effort, please do not hesitate to contact us.

Very truly yours,

Jerrold L Jacobs

pl

Attachment

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RESPONSE TO REPRESENTATIVE CORCORAN'S
LEGISLATIVE APPROACH TO THE
PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Commentary re Question 1 of Approach Two: To what extent, if any, would this approach lead to utility diversification?

Let us take each of the three individual proposals contained within Approach Two and examine the implications for Atlantic Electric. These answers are framed from our "perspective as representing an exempt holding company filing SEC statements pursuant to Rule 2".

"Approach Two: Amend Section 3 of PUHCA,

1. first, to exempt holding companies with only one public utility subsidiary, provided such subsidiary's operations are limited to its state of incorporation and contiguous states; ..."

Comparison to original PUHCA: See Section 3(a)(1) which exempts "any holding company and any subsidiary company thereof ... if

1.) such holding company and every subsidiary company thereof which is a public utility company ... are predominantly intrastate in character and carry on their business substantially in a single state in which such holding company and every such subsidiary company thereof are organized; ..."

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AE's corporate structure (with the Deepwater Operating Company subsidiary, itself a public utility) is such that it would appear to qualify for exemption under both original and amended Section 3(a)(1). The broadening of the allowable geographical area under amended Section 3(a)(1), however, would have limited impact on any AE diversification decision. Indenture restrictions contained in AE's mortgage and deed of trust can still be an impediment to diversification since AE is both an electric utility and a conditionally exempt holding company.

2. "second to exempt holding companies created by companies that are presently exempt under Section 3(a)(2) of the Act; ..."

Comparison to original PUHCA: See Section 3(a)(2) which exempts "... any holding company and any subsidiary company thereof ... if

2.) such holding company is predominantly a public utility company whose operations as such do not extend beyond the state in which it is organized and states contiguous thereto; ..."

We assume by this proposal that the original Section 3(a)(2) exemption will be left in force. It is our opinion, considering AE's corporate structure, that Section 3(a)(2) is also an applicable exemptive provision. AE is currently considering diversification options. However, in our opinion,

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indenture restrictions contained in AE's mortgage and deed of trust can still act as a constraint on diversification.

3. "third, to remove the 'unless and except' clause." Comparison to original PUHCA: See Section (3) which reads as follows:

"SEC. 3.(a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if ..." (emphasis added)

In order to properly analyze the probable effects of the removal of the "unless and except" clause, it is necessary to examine current interpretations of the question of diversification versus public interest as regards a conditionally exempt holding company. The SEC, in the Pacific Lighting Case, developed guidelines as to what it considered "prudent and limited diversification" for Section 3(a)(1) conditionally exempt holding companies.

1. All non-utility activities should be segregated from utility activities through separate corporate subsidiaries.

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2. There should be no services, materials or other contracts between the utility and the other subsidiaries except to the extent such contracts are subject to the supervision of state regulatory commissions.

3. There should be no use of utility operating management, funds or credit for non-utility purposes.

4. With respect to any non-utility activity or business which does not have a functional or operating relationship to the utility business, we would require that non-utility investments, both individually and on an aggregate basis constitute only a relatively small component of the entire system.

With regard to this topic, however, we have learned that "the practice of the SEC staff is not to look at the degree of diversification .... There is not even a 50% utility vs. non-utility related activity threshold for staff action. Instead, the staff looks to see whether the nature of the diversification and the financial transactions that accompanied it have put the financial health of the holding company and/or utility subsidiaries in jeopardy."

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5. Non-utility investments should be restricted to activities which are either complementary in a significant way to the utility operations or have an established and successful record, such as a history of stable or increasing earnings for a reasonable period of time.

In our opinion, the above guidelines largely parallel the requirements which a prudent management team would impose on itself. The only real restriction these guidelines create would be in the case where the conditionally exempt holding company wished to start "from scratch" a business which was not "complementary in a significant way to the utility operations" (or in the case where the holding company wished to buy a faltering business enterprise which was not "complementary ...").

The effect of removing the "unless and except" clause is to eliminate the basis for the SEC's having to decide when diversification is contrary to the public interest or the interests of investors or consumers. The guidelines currently used by the SEC are, as we have seen, rather liberal (not far removed from the self-imposed requirements of prudent management). However, they could change, perhaps become stringent, as the result of legislation, SEC policy or rule changes or judicial or SEC decisions. If the criteria became less liberal, holding

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companies would be faced with possible forced divestiture of profitable subsidiaries. The removal of the "unless and except" would allow more wide-ranging diversification and would remove much uncertainty among management as to later forced divestiture. However, even if the "unless and except" clause were removed, indenture restrictions would still act as a constraint on diversification for companies structured in the same manner as AE.

In sum, it is our opinion that the proposed changes will have relatively little practical effect on diversification activities at Atlantic Electric.

Question 2

1. Effect of enactment on our state PUC (New Jersey Board of Public Utilities).

Diversification has been termed a "natural enemy" of state regulatory commissions. Recently the Wisconsin Public Service Commission determined in a policy statement that it has jurisdiction over formation of holding companies by utilities in the state. We are not aware of any similar policy statement issued by the New Jersey BPU. In any case, AE is already a conditionally exempt holding company.

We know of no real statutory power possessed by the BPU at this time that would block diversification by AE under the existing or amended PUHCA. The only weapon possessed by the BPU to discourage diversification would be to delay rate relief.

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2. Effect of enactment on utilities.

This depends upon, first, the current corporate structure of the utility involved - whether it is solely an electric (or gas) utility or a utility that is part of a holding company structure. Secondly, any future action by the NJBPU similar to that taken by the Wisconsin Public Service Commission would have a profound effect on those utilities that are not already part of some holding company structure.

We believe that the legislation would have little effect (given current SEC position on and interpretation of diversification issues for conditionally exempt holding companies) on utilities situated similarly to AE.

3. Effect of enactment on stockholders.

We believe that enactment would have a favorable impact on our stockholders and on the financial community in general. Even if utilities do not take full advantage of the amendments, the announcement effect of the amendments would indicate that Congress is becoming serious about the financial problems of the utilities.

4. Effect of enactment on ratepayers.

Loosening of existing PUHCA requirements would probably be met with resistance by consumer advocate groups. They believe that holding companies connote big business and anti-consumerism. In our opinion, they would oppose legislation which would broaden the exemptive provisions and would at least appear to broaden the allowable diversification.

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COLUMBIA GAS
System

W. F. Laird
Chairman and President

November 25, 1981

The Honorable Tom Corcoran
The United States House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

Re: Public Utility Holding Company Act
Your Letter of October 27, 1981

I appreciate the opportunity to respond to your letter of October 27, 1981. I encourage you in your efforts to revise the Public Utility Holding Company Act to reflect the changes that have occurred since the 1920s and '30s.

We have reviewed the response to questions you raised with the two other gas utility public holding companies in existence, namely: Consolidated Natural Gas Company and National Fuel Gas Co. We agree with the answers attached to the response to you of November 23, 1981 by Mr. G. J. Tankersley, Chairman of Consolidated.

Please advise if I may be of further assistance.

Yours very truly,

WLaird

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POTOMAC ELECTRIC POWER COMPANY
1900 PENNSYLVANIA AVE., N.W.
WASHINGTON, D.C. 20068

W. REID THOMPSON
CHAIRMAN OF THE BOARD
PRESIDENT

November 25, 1981

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
1107 Longsworth House Office Building
Washington, DC 20515

Dear Mr. Corcoran:

Thank you for your October 27, 1981 letter in which you discuss possible amendments to the Public Utility Holding Company Act. I am encouraged that you as a Congressman understand the present financial plight of the utility industry and want to take steps to alleviate its serious economic problems.

Potomac Electric Power Company (PEPCO) heartily endorses the second approach outlined in your letter regarding amendments to the Public Utility Holding Company Act., i.e., to amend Section 3 of the Act (1) to exempt holding companies with only one public utility subsidiary, provided the subsidiary's operations are limited to its state of incorporation and contiguous states; (2) to exempt holding companies created by companies that are presently exempt under Section 3(a)(2) of the Act; and (3) to remove the "unless and except" clause. These proposed amendments would allow more utilities to diversify into non-regulated businesses which would ultimately improve the financial condition of those utilities.

Not only are utilities earning far below their authorized rates of return, due to inadequate and untimely rate relief, but also those authorized returns are far below the rates necessary to obtain adequate capital on a competitive basis. Diversification into businesses outside of the public utility arena would provide utilities an opportunity to improve their financial condition by enabling them to earn a return on their investment in non-regulated industries commensurate with the risk involved.

The preferred structure for a utility wishing to undertake diversification activities is the creation of a holding company, exempt under the Public Utility Holding Company Act, with separate corporate subsidiaries for its utility and non-utility operations. This corporate structure provides the best mechanism to avoid any cross-subsidization between the ratepayers and shareholders of a public utility. Cross-subsidization should be avoided for

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the sake of both the ratepayer and the shareholder because the ratepayer, who would bear none of the risk of non-utility diversification, should pay only the cost of utility service, and the shareholder, who would bear all the financial risk of non-utility diversification, should have the opportunity of financial reward.

Under the present structure of the Public Utility Holding Company Act, PEPCO could not form an exempt holding company because its utility operations extend beyond one state.* The proposed Approach 2 amendments to the Act would afford PEPCO the opportunity to establish a holding company structure with presently structured PEPCO as a corporate subsidiary. Such a structure would not impair our utility service and would allow us the opportunity to engage in other industries to improve our financial condition.

Regarding the need to remove the "unless and except" clause under the Act, such an amendment is critical to the expanded use of the holding company structure. The existence of the clause has a chilling effect on diversification activities of utilities. Presently an exemption may be revoked by the Securities and Exchange Commission; a company which loses its exempt status would be subject to the forced sale of non-utility businesses, the forced divestiture of either its gas or electric business in the case of a combination electric and gas utility, and the additional regulation imposed by the Act, including the prohibition against diversification into areas not functionally related to the utility business enterprise.

If the Act were amended to allow more utilities to engage in non-functionally related businesses through a holding company structure, PEPCO submits that there should be no effect on a diversified utility's ratepayers. All the risk (and any reward) of diversification activities should be properly with the utility's shareholders and should be treated as such by a state regulatory commission. However, to the extent that diversification benefits the utility's overall financial performance, diversification could provide indirect benefits to ratepayers.

The questionable practices which gave rise to the Public Utility Holding Company Act would not recur if the Act were amended to afford more companies the opportunity to establish an exempt holding company structure without the threat of revocation of that status. State public utility commission regulation, federal utility regulation, and accounting standards have been developed since the 1935 Act to protect the interests of investors and consumers. There is no longer any justification for subjecting the utility industry to strict federal controls which are not imposed upon other industries.

We urge you and the other members of your committee to continue your efforts to spur economic growth and reduce governmental regulation. In this regard, we urge you to further pursue amendments to the Public Utility Holding Company Act. We thank you for affording us the opportunity to share our views on this issue with you.

Sincerely yours,

W. Reid Thompson

* As you know, PEPCO serves the District of Columbia, parts of Maryland and a small section of Northern Virginia.

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INTERMOUNTAIN GAS COMPANY
BOISE, IDAHO

WALTER H. SMITH
PRESIDENT
CHIEF EXECUTIVE OFFICER

P. O. BOX 7608
83707
(208) 377-6000

November 25, 1981

Honorable Tom Corcoran
Representative 15th District
State of Illinois
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman:

Your inquiry addressed to Intermountain Gas Company concerning the two legislative approaches to the Public Utility Holding Company Act of 1935 has been a subject for discussion of my staff for the past two or three weeks trying to determine what if any comments we might make pertinent to your inquiry.

It occurs to me that in the first instance that efforts to avoid the obscurities stated in the preamble of the act, the state public utility commissions, since 1935, have become substantially more sophisticated and competent to regulate all utility company activities within their borders that are not otherwise preempted by regulatory acts of Congress. In addition to this, the communication and reporting capabilities of the companies, the public entities, and the media are also infinitely more competent and reliable than we had in the 30's. I think both of these observations are pertinent to your inquiry and form the basis upon which I have approached your questions.

APPROACH ONE

Question One: Because of various regulatory agencies and obligations of disclosure, the utility industry probably no longer presents the unreachable complexities that the Act intended to correct.

Question Two: The state and federal laws are now adequate to protect stockholders and ratepayers.

Question Three: There are presently areas of conflict between state regulatory agencies, but these seem to find resolution in the day-to-day responsibilities of these agencies.

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Question Four: I would say that the ratepayers of Idaho look upon the State Public Utility Commission as the sole protector of their rights and interests and recognizes little or no federal responsibility.

Question Five: It is doubtful that much diversification would be pursued by public utilities nor would I anticipate too many mergers because of inherent difficulty in adhering to the specific recommendations of the various accounting requirements mandated by the state and federal regulatory agencies. There may be a remote possibility that repeal of the Act could help utilities raise capital for their ever increasing needs to supply energy demands in this country.

APPROACH TWO

Question One: Diversification under the amendments therein stated may encourage limited utility diversification.

Question Two: I do not anticipate such an enactment would affect the Public Utility Commission of the utilities in Idaho.

The comments that I have made in response to your inquiries were based on limited first-hand experience and from cursory review of the Act of 1935. It is not intended to be an exhaustive research into the complex ramifications of the questions. Such an inquiry is beyond the capabilities of our staff.

I trust that these responses will be of some value to you and your committee.

Very truly yours,

Walter H. Smith

RBH:WS:plp

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PACIFIC GAS AND ELECTRIC COMPANY

77 BEALE STREET • SAN FRANCISCO, CALIFORNIA 94106 • (415) 781-4211

JOHN E. KOEHN
VICE PRESIDENT GOVERNMENTAL RELATIONS

November 25, 1981

Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Corcoran:

Frederick W. Mielke, Jr., has asked that I respond to your letter of October 27, 1981, soliciting the views of Pacific Gas and Electric on proposals to amend the Public Utility Holding Company Act of 1935.

Your concern about the financial difficulties and regulatory constraints which confront the utility business is quite appropriate. For a number of years, investor-owned gas and electric utilities across the country have been trying without much success to secure reforms of various laws and regulations which impede the ability of utilities to conduct their business in an efficient manner. Inasmuch as the Public Utility Holding Company Act of 1935 is perhaps foremost among those federal laws which constrain the manner in which utilities may organize their business activities, I welcome the opportunity to provide you with our views on the benefits which would flow from modifying that statute.

I have attached detailed comments on the two alternatives outlined in your letter. In reviewing these and other responses you may receive, I urge you to consider the subject of diversification in the context of the overall financial condition of the utility industry, and to bear in mind that unless financial health is restored, the ability of the utilities to provide adequate service will be jeopardized.

Once again, PGandE appreciates the opportunity to comment on this issue. If we can further assist you in any way in implementing the reforms outlined in the attached, please let me know.

Sincerely,

JEK:ta
attachment
cc F. W. Mielke, Jr.

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COMMENTS ON PROPOSED REFORMS OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

On October 27, 1981, Rep. Thomas Corcoran requested the Pacific Gas and Electric Company's ("PGandE" or "Company") views on two alternative reforms of the Public Utility Holding Act of 1935 ('35 Act). The following comments respond to that request.

Overview

As has been made abundantly clear in the recent Congressional hearing on utility "least-cost strategies," the electric utility industry is generally in unhealthy financial condition. Continuing inflation, rising fuel costs, unprecedented capital costs for new generation facilities, and delays and failures in adequate rate relief are just a few of the factors which have resulted in earned rates of return for utilities being below levels authorized. In turn, the inability of utilities to earn a reasonable rate of return has sapped their financial strength, heightened investor perception of the risks associated with utility securities, and resulted in low market to book ratios and falling utility bond ratings.

PGandE's financial situation is representative of most of the other major gas and electric utilities. Over the last ten years the rates set by the CPUC have resulted in customers paying about $1.4 billion less than it has cost PGandE to provide them with service. In 1981 alone the Company estimates that the shortfall between rates and the amount needed to earn the rate of return of CPUC has previously found reasonable will amount to $311 million. As a result, the estimated earned rate of return for 1981 will only be 8.2 percent - not even close to the 14.1 percent the CPUC has authorized.

The extreme disparity in earned versus authorized rates of return has, of course, been borne by Company shareholders. The securities markets have properly perceived this to be the case, as PGandE's present low market value to book value ratio of approximately 73 percent confirms. With debt costs at record levels and each additional equity issue causing a further dilution of current shareholder's interests, PGandE faces the same hobson's choices which are familiar to most utilities across the country. Unless broad relief is forthcoming PGandE and other utilities will have difficult choices to make which will ultimately affect the level and quality of utility service in the future.

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Given the variety of factors which have caused the present dilemma, it is clear that no single action will solve the utility financial problems. For that reason, PGandE does not view the "diversification option" as a panacea. Without a strong general economy, a stable monetary system, and timely and adequate rate relief, financial problems will persist for PGandE and the utility industry as a whole.

Despite the fact that diversification is thus not being viewed as critical to the recovery of utility financial health, PGandE does perceive that under the right circumstances diversification activities can contribute to that recovery. Properly utilized, diversification can both provide new revenue streams and stabilize overall profits. Moreover, diversification can and should be justified not only because any resulting profits will allow investors to realize a full market return on their utility assets, but also because it results in the production of additional goods and services from existing but underutilized assets. In today's shrinking global resource base such underutilization should not be so easily countenanced.

Despite the fact that utilities like PGandE believe that there may be significant opportunities and benefits, both to its shareholders and indirectly to its ratepayers, which would result from diversification in business operations, to date few utilities have taken this course of action. A primary reason for the lack of diversification is that although the utility shareholders would likely bear the risk of failure in these endeavors, it is not clear that those shareholders would also stand to realize any benefits. This perceived disparity in treatment is in part a regulatory problem and in part an organizational or structural problem. More simply put, due in large part to the '35 Act there is currently no acceptable structural mechanism by which utility corporations which choose to devote shareholders assets into non-utility investments can be assured that the returns resulting will be insulated from the reach of utility regulatory bodies.

Approach One - Repeal of PUHCA

As an independent operating combination electric and gas utility company PGandE is not currently required to be registered under the '35 Act. 1/ To the extent that PGandE

1/ PGandE has no electric utility subsidiaries and none of its gas company subsidiaries sell natural gas at retail.

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established any jurisdictional gas or electric subsidiaries, it would anticipate that such activities would qualify for exemption under various existing statutory provisions and Securities and Exchange Commission (SEC) implementing rules and regulations (e.g., section 3(a), rules 2, 7, 14, 15, 16).

The fact that PGandE currently is not subject to the '35 Act 2/ is a reflection of a conscious decision by PGandE to avoid becoming subject to what the Company construes to be inappropriate and often duplicative restrictions contained in the Act. 3/ From PGandE's perspective repeal of the '35 Act would thus not directly relieve it of any regulatory burdens. It would, however, clearly remove a primary obstruction which prevents PGandE from creating a parent holding company and thus diversifying through insulated subsidiaries. For that reason the Company would endorse repeal of an act which has long since served its purpose.

That the principal mission to be served by the '35 Act has largely been accomplished can hardly be denied. In 1971 the SEC acknowledged as much in a letter to Senator Magnuson in which the SEC proposed that its '35 Act functions be transferred to the Federal Power Commission (FPC). In that letter, then Chairman Casey wrote:

2/ As is the case for any person, PGandE is subject to the requirements of section 9(a)(2) concerning utility acquisitions.

3/ Although PGandE would initially qualify for an exemption, exemptions may be revoked or conditioned at any time by the SEC due to changed circumstances. In the event PGandE created a parent holding company and subsequently lost its exemption, it would become subject to the '35 Act. Under the corporate simplification process applicable to utilities subject to the Act PGandE might be required to divest either its gas or electric business to meet the "single integrated utility" standard applicable to holding companies. It is this possibility above all others which has precluded PGandE from activities which might conceivably bring PGandE within the confines of the Act.

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> "[t]he principal mission entrusted to the Commission by the Congress through enactment of the Public Utility Holding Company Act was largely accomplished during the first twenty years of the Act's history. This was to eliminate or reorganize the complex, unwieldly, and unsound utility holding company structures which had been built up during the 1920s and which Congress determined to be contrary to the public interest." (CCH Fed. Sec. Law Rept. '72-73 Dec. ¶78,928)

To the extent that Chairman Casey acknowledged that the SEC was then actively engaged in '35 Act activities, it was either in connection with securities issuances and minor acquisitions by registered holding companies, or in considering large scale multiutility generating plant projects. 4/ As to the latter, Chairman Casey opined that the FPC had already been involved in evaluating those projects for a number of years and that in any event:

> "the nature and motivation of this [generating station] development is, however, quite different from that which existed in the 1920s. Then, holding company empires were built up primarily as promotional ventures accomplished by the manipulation of corporate structures for the profit of those who engaged in these activities. The current interest is more a response to technological developments . . . ." [Id at p. 81,994]

In the utility industry, as in other parts of the nation's economy, the structural concerns which may have been appropriate in the 1920s no longer are valid today. During those times the electric utility industry was in the stage of transition from multilayer local generation and distribution formats to the present day large integrated, reliable generation, transmission, and distribution structures. Although the technology is complex, the

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4/ In adopting Rules 14 and 15 earlier this year the SEC has in many respects disclaimed the need to evaluate the effects of large scale multi-utility generating plants, at least where it is assumed that other state and federal agencies are reviewing those projects.

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structural complexity has largely disappeared as utility systems merged, matured or, in some cases, were divested.

Similarly, the regulatory environment has changed considerably since the 1920s. To the extent that the '35 Act was largely a reaction to securities manipulation and accounting abuses, the present environment bears no relationship to that time. Not only has the SEC's involvement, in the form of the enforcement of the Securities and Exchange Acts of 1933 and 1934, dramatically shaped present disclosure and accounting practices, but the FPC (now FERC) uniform system of accounts has also controlled the abuses focused on in the '35 Act.

At the state level, the regulatory oversight and control has been no less pervasive. In California, for example, PGandE's activities in the securities area must conform to both the applicable provisions of the California Corporation Code (e.g., section 500 et seq. governing distributions to shareholders) and to the close securities oversight exercised by the CPUC.

In view of this substantial change in both structural circumstances and in the regulatory framework since the '35 Act was adopted, it does not appear that repeal of the '35 Act would have an adverse affect on utility practices, at least as viewed from PGandE's perspective. As applied to PGandE (in the event a parent holding company was formed to facilitate diversification) the Act would merely duplicate the regulatory framework currently in place.

Approach Two - "One Subsidiary" Modification

As PGandE interprets this approach, the Act would be modified to allow a parent holding company to be established, provided there was only one public utility subsidiary with the holding system and that the utility subsidiary's operations were geographically limited. An exception would apply to holding companies which are presently exempt under section 3(a)(2) by virtue of the fact that they are predominantly a public utility company whose operations as such do not extend beyond the state of organization and states contiguous. In addition, Section 3 of the Act as presently written would be amended to remove the "unless and except" clause, the effect of which would be to make exemptions permanent so long as the statutory

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standard is met. PGandE views this latter provision as being particularly important. 5/

Generally speaking, PGandE would enthusiastically support an amendment of the sort suggested. To be functional for PGandE, however, the amendment should provide that an existing combination gas and electric utility company will be construed to be a single public utility subsidiary for the purposes of the exemption. 6/ In PGandE's case such an amendment would remove a key structural obstacle to diversification and would greatly increase the likelihood that some form of diversified activity would occur. Of course, whether in fact PGandE would engage in any diversified business activities would ultimately depend on whether the perceived benefits for its shareholders would outweigh the risks associated with that activity and whether it is able to devote capital to those activities.

Although enactment of the "one subsidiary" exemption would remove the '35 Act regulatory obsticle, PGandE does not believe that either the CPUC or PGandE ratepayers would be compromised as a result. Under sections 851 and 854 of the California Public Utilities Code the disposition or encumbrances of public utility property and the acquisition of control, either directly or indirectly, of any California

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5/ Although PGandE believes that it would qualify for exemption by rule or order under Section 3 of the Act if it were presently to create a parent holding company structure, the existence of the "unless and except" clause has prevented PGandE from doing so. PGandE believes that the inherent risk of divestiture associated with SEC withdrawal of exemptions by use of that clause have not justified the creation of a holding company. Moreover, as applied by the SEC in the Pacific Lighting Corporation case, the level of diversification currently allowed exempt companies is extremely limited.

6/ In order to facilitate certain generation projects the amendment should also provide that use of the "one subsidiary" exemption should not preclude the ability of the parent, either directly or through the subsidiary, from taking advantage of Rules 14 and 15 and other applicable exemptions for creation, in conjunction with other utilities and investors, of regional generation companies.

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public utility must be approved by the CPUC. Thus, although the parent holding company would not itself be a jurisdictional entity, the CPUC would nonetheless initially be required to review the holding company-subsidiary company relationship.

Beyond the initial review, the CPUC would, of course, continue to review, monitor and regulate the activities of the public utility subsidiary to the same extent as is currently the case. In that context, the CPUC has for many years reviewed utility-related transactions between jurisdictional entities and their parents and subsidiaries and has adopted a general rule that an affiliate is not entitled to realize a rate of return on those intra-system transactions in excess of that allowed the utility by the CPUC. Given this scope of review which the CPUC has exercised in the past and the broad ambit of authority to review utility actions which affect the ratepayers and the public, there is simply no reason to believe that an amendment of the sort contemplated would adversely affect ratepayers. Indeed, to the extent that the effects at diversification are successful, the strength of the overall system and the more efficient use of current utility resources should benefit ratepayers.

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PACIFIC GAS AND ELECTRIC COMPANY

77 BEALE STREET · SAN FRANCISCO, CALIFORNIA 94106 · (415) 781-4211

See also response of Nov 25, 1981

FREDERICK W. MIELKE, JR.
CHAIRMAN OF THE BOARD

January 12, 1982

DATE ANS DOC #: REC #

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DAYS NOTES: al

Hon. Tom Corcoran
1107 Longworth House Office Bldg
Washington, D.C. 20515

Dear Representative Corcoran:

Thank you for your letter of December 23, 1981, enclosing a copy of HR 5220, the "Public Utility Financial Reform Act," which you introduced on December 15.

As Mr. J. E. Koehn indicated in his letter of November 25 on this subject, PGandE strongly supports repeal or reform of the Public Utility Holding Company Act to allow utilities greater flexibility to organize their business activities and to restore their financial health. HR 5220 goes a long way towards achieving this goal.

As noted in the materials Mr. Koehn sent, however, the desired positive effect of this legislation will not be achieved unless language is included to clarify that an existing combination gas and electric utility company will be construed to be a single public utility subsidiary for the purposes of the "single subsidiary" exemption. I have enclosed suggested language to accomplish this change which I hope you will seriously consider inserting in HR 5220. Without this addition, the bill will be of little relevence to PGandE and the many other similarly placed combination gas and electric utilities throughout the nation.

We look forward to working with you on this and other proposals to reform or repeal the Act. If our Washington Office can be of assistance, please do not hesitate to let Ralph Dewey or John Vance know (1050 - 17th Street, N.W., Suite 1180, Washington, D.C. 20036; telephone 296-8656).

Sincerely,

Frederick W. Mielke, Jr.

FWM:mm

cc J. E. Koehn
Ralph Dewey
John Vance

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AMENDMENT TO HR 5220 AS INTRODUCED ON DECEMBER 15, 1981

Amend Section 4 of the bill as follows (additional language underscored):

"Sec. 3. (a)

"(6) such holding company has only one subsidiary public utility company and such subsidiary public utility company's operations as such do not extend beyond the State in which it is organized and States contiguous thereto. For the purposes of this subsection, a combination gas utility company and electric utility company in existence on December 15, 1981, shall be deemed to be a single public utility company."

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THE WASHINGTON WATER POWER COMPANY

P.O. BOX 1737 • SPOKANE, WASHINGTON 99210 • (509) 489-0500

RENDELL J. SAYRE
PRESIDENT
CHAIRMAN OF THE BOARD

November 25, 1981

Honorable Tom Corcoran
Representative in Congress
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Corcoran:

In answer to your letter of October 27, 1981, with reference to the Holding Company Act, I must first state emphatically that in my opinion, the Public Utility Holding Company Act of 1935 has long outlived its usefulness, is an unnecessary and overlapping layer of regulation and should be repealed.

I would therefore support "Approach One" and answer your questions as follows:

Question 1. In my opinion the utility companies do not continue to present the problems of size and structural complexity the Act was intended to correct. The utility industry is much less concentrated than many other industries, it is subject to the antitrust laws and to the 1933 and 1934 Securities and Exchange Acts as are other industries. In addition, utilities are regulated as to accounting and in certain instances as to issuance of securities by the Federal Energy Regulatory Commission under the Federal Power Act.

Question 2. In my opinion the Federal Power Act, the Securities and Exchange Acts, the federal antitrust laws and the state regulatory laws adequately protect the interests of stockholders and ratepayers.

Question 3. The Public Utility Holding Company Act now regulates only a segment of the utility industry and if repealed would have little effect on the regulation by the states of a great majority of utility companies. To the extent there may appear to be the possibility of a conflict between states, it has never developed into a major problem.

Question 4. I seriously doubt that the public has any concept of the overlapping regulation created by the Public Utility Holding Company Act, the Federal Power Act, the Securities and Exchange Acts and state regulation. As mentioned above, the Holding Company Act regulates only a segment of the industry. Someone dedicated to the concept of the Act perhaps

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could arouse a public response to a proposed repeal, but such a response would not be based on the facts objectively presented.

Question 5. There are no holding companies presently operating in the states in which this Company operates and therefore there would be no immediate effect on the state PUC's, utilities, stockholders and ratepayers. It is entirely speculative whether repeal of the Act would result in increased diversification of the industry, particularly if by diversification is meant the entry into completely unrelated businesses. The principal benefit from repeal of the Holding Company Act would be to allow Companies such as ours to use more flexibility in methods of financing, particularly in the financing of new generating plants. In addition to complying with federal securities laws, our Company must receive approval from both the Washington and the Idaho State Commissions for any type of long-term financing it may do. The limitations of the Holding Company Act on top of these restrictions is arbitrary and is a very good example of over-regulation.

With respect to "Approach Two", the first problem that arises is the continuation of the present ambiguous language in the Holding Company Act which refers to the "state of incorporation and contiguous states." This Company is incorporated in the State of Washington and has an integrated system which operates in the eastern part of Washington, the northern panhandle of Idaho and the western part of Montana. It is not possible to get a firm legal opinion as to whether the permitted exemption under the Act includes such a condition or whether each of the states must adjoin the state of incorporation. There is no rational reason for this distinction and if Approach Two is used, it is hoped that this language will be clarified.

In answer to your questions related to "Approach Two , I would hesitate to speculate as to whether the enactment of these types of amendments to the Holding Company Act would result in increased diversification. We have made no study of a plan to create a holding company which would own the stock of the present utility company. I am aware that other companies have made such studies and would defer to them.

Sincerely,

W. J. Satre

Wendell J. Satre
President

S.bw

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MIDDLE SOUTH UTILITIES, INC BOX 61005/NEW ORLEANS, LA 70161/(504) 529-5262

FLOYD W. LEWIS
CHAIRMAN/PRESIDENT

November 27, 1981

Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Corcoran:

Middle South Utilities is pleased to respond to your request for comments on the repeal or modification of the Public Utility Holding Company Act of 1935. The Middle South Utilities System is a registered holding company system subject to regulation under the PUHCA, of which there are only a small number. We feel strongly that the primary purpose of the PUHCA -- the corporate simplification and geographical integration of public utility holding company systems -- has been accomplished. Because of this simplification and integration, because of the maturation of state and local regulation over the last 46 years, and because of Federal securities and utility regulatory legislation that duplicate many provisions of the Act, there is no longer justification for continuing this extra layer of bureaucratic regulation and to do so could be considered wasteful.

These and other justifications for total repeal of the PUHCA are further discussed in the attachment, "Repeal of the Public Utility Holding Company Act of 1935." We have reviewed the two legislative approaches included in the attachment to your letter and we favor Approach One, the repeal option.

Our responses to your questions are as follows:

Questions on Approach One (Repeal)

Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct?

Response: The PUHCA had, by the early 1950's, completely achieved its objective of dramatically reducing the size and structural complexity of holding company systems. There are no more geographically dispersed holding company systems but rather all of today's holding company systems are operated as geographically integrated public utility systems. A large number of the Fortune 500 industrials typically have many more subsidiaries than the average utility holding company system.

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Question 2: To what extent would federal and state law adequately protect the interests of stockholders and ratepayers were PUHCA to be repealed?

Response: The protection of investors was one of the primary reasons that the PUHCA was enacted. It is this same protection of 'investors' interests that we feel is one of the most compelling reasons for repealing the Act today. The holding company systems still subject to the Act must carry an extra layer of regulation which is not applicable to another utility of equal or greater size with comparable multi-state service area which is organized as a single corporation. All of the protections afforded stockholders in such a single corporation would be afforded the stockholders of a utility holding company after repeal of PUHCA and, in addition, freedom to pursue economic opportunities to improve stockholder returns would be enhanced.

After repeal of the PUHCA, the stockholders of a holding company would still enjoy the protection of the 1933 Securities Act, the 1934 Exchange Act, and, for utilities, the Federal Power Act and Natural Gas Act.

The PUHCA is also unnecessary for the protection of ratepayers because of the maturation of state and local regulation in the past 46 years. For instance, Mississippi did not even have a public service commission until the mid-1950's. But now that state and all of the other rate regulatory authorities have the power to address the reasonableness of costs incurred in affiliate transactions or the allocation of costs between utility and non-utility businesses for purposes of ratemaking.

After repeal of the PUHCA, the state regulatory agencies will continue to have control over the lifeblood of the companies -- their utility rates.

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

Response: We do not believe that repeal of PUHCA will result in conflicting state regulation.

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

Response: We believe that very few members of the public have any concept of the regulation of holding companies by the SEC under the PUHCA. The majority of the public today looks to the state PUC's for supervision of financing, inter-company transactions, and other functions duplicated by the SEC under the PUHCA. There appears to be no lack of confidence in the state commissions in these areas.

Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

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Response: We believe that there will be no adverse effects from repeal of the PUHCA. On the contrary, we feel an unnecessary and costly regulatory burden will be removed with the resultant savings benefiting all of the mentioned parties.

As for diversification, we believe repeal of the PUHCA will permit but will not necessarily lead to diversification. It is only the existence of more attractive investments that will encourage diversification.

Questions on Approach Two (Modification)

Question 1: To what extent, if any, would this approach lead to utility diversification?

Response: This proposed modification of the PUHCA would not exempt the Middle South Utilities System and, therefore, we would find ourselves still subject to the Act's restraints on diversification. To enjoy the same regulatory status as most other utility companies, we would have to change our form of organization, merging all of our operating companies into one utility.

For those companies which are not now holding companies, a one utility holding company exemption would facilitate diversification using the holding company model. We reiterate our comment in our response to Question 5 above that permitting diversification is only one condition. Of a greater necessity is the existence of more attractive investment opportunities.

Question 2. In your opinion, how would enactment affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would enactment lead to diversification?

Response: While we would prefer this modification to the status quo, we could be harmed if the legislation continued to single us and other non-exempt holding companies for an extra layer of regulation while other utilities, similar in all other respects to us, were released.

Our previous comments on diversification apply here also.

We would like to thank you for your interest in this issue. Your consideration of repeal of the PUHCA is very encouraging to us. While "deregulation" is desirable, we submit that "delegislation" with respect to laws and agencies that are no longer needed is preferable. We would be pleased to discuss these matters further with you.

Sincerely,

FWL:js
Enc.

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MIDDLE SOUTH UTILITIES, INC./BOX 61005/NEW ORLEANS, LA 70161/(504) 529-5262

FLOYD W. LEWIS
CHAIRMAN/PRESIDENT

December 29, 1981

Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Corcoran:

Thank you for your letter of December 23, 1981, in which you enclosed a copy of H.R.5220 the "Public Utility Financial Reform Act".

While H.R.5220 would allow many electric utilities the flexibility to form holding companies without being subject to the outdated requirements of the Public Utility Holding Company Act of 1935; it unfortunately does nothing in regard to providing relief to the twelve holding company systems which are presently subject to the Act.

You will recall that my letter of November 27, 1981, in response to your questionnaire, suggested that the Public Utility Holding Company Act be repealed. Since my correspondence with you, two significant events have occurred. The first was the recent unanimous recommendation of the Commissioners of the SEC that the Act be repealed. The second was the introduction of S1977 by Senator J. Bennett Johnston to repeal the Act. Senator Johnston introduced S1977 without prior knowledge of the recommendation forthcoming from the SEC Commissioners.

In light of these developments and your desire to pursue a course of action that will bring about positive results for all concerned parties, I hope you will consider the sponsorship of repeal legislation in the House.

Your continued interest in this issue is certainly appreciated and we hope that hearings can be scheduled as soon as possible after Congress reconvenes.

Sincerely,

FWL:daa
cc: Senator J. Bennett Johnston
Representative Billy Tauzin
Mr. Bill Timmons

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GENERAL
PUBLIC
UTILITIES
CORPORATION

William G. Kuhns
Chairman
100 Interpace Parkway
Parsippany, New Jersey 07054
(201) 263-6500

November 25, 1981

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The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

I acknowledge receipt of your letter dated October 27, 1981 seeking my comments on possible repeal or amendment of the Public Utility Holding Company Act. As the owner of Three Mile Island nuclear generating station, we continue to be preoccupied with matters relating to that station, its regulatory treatment and the critical cleanup funding program, to an extent that has caused us to play a rather passive role in considering possible changes in the holding company act. I hope you will understand that this TMI preoccupation continues to deprive me of any ability to give you a thoughtful and detailed consideration to the questions you have raised.

Certainly it is clear that circumstances have changed dramatically from those which led to the enactment of the Public Utility Holding Company Act. It is indeed appropriate that changes in this federal law be considered.

Sincerely,

WGK:mn

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National Fuel

NOV 25 1981

Louis R. Reif
President and Chief Executive Officer

November 23, 1981

The Honorable Tom Corcoran
Representative 15th Illinois District
205 North Lake Street
Aurora, Illinois 60506

Re: Public Utility Holding Company Act

Dear Tom:

As you know we have been working with the two other gas companies in the nation still subject to the Public Utility Holding Company Act. National Fuel Gas Company joins in the views expressed by Jack Tankersly on behalf of Consolidated, Columbia and National Fuel in his recent letter to you. In addition to the points expressed therein, National Fuel would like to emphasize the common consensus that the Public Utility Holding Company Act of 1935 is obsolete and anachronistic. The simplest solution to relieving the American utility industry of this impediment and relieving the American taxpayer of the cost of administering this burden is the repeal of the Holding Company Act.

We understand that there are some people who may express the feeling that parts of the Holding Company Act should be preserved and that other parts should be modified in order to achieve some particular goals. We suggest that the most efficient approach to achieve those specific objectives is to repeal the Public Utility Holding Company Act of 1935 and then to pass specific legislation designed to deal with today's problems. Dealing with a variety of modifications and amendments is needlessly time consuming and complicated and will leave us merely with a patched up version of an obsolete law.

Very truly yours,

NATIONAL FUEL GAS COMPANY/10 LAFAYETTE SQUARE/BUFFALO NY 14203

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BALTIMORE GAS AND ELECTRIC

CHARLES CENTER · P. O. BOX 1475 · BALTIMORE, MARYLAND 21203

GEORGE V. McGOWAN
PRESIDENT

November 30, 1981

Hon. Tom Corcoran
1107 Longworth House Office Bldg.
Washington, D.C. 20515

Re: Public Utility Holding Company Act

Dear Congressman Corcoran:

Your letter of October 27, relative to alternative approaches to changing the Public Utility Holding Company Act of 1935, is quite timely, since, as you know, a number of utilities are now actively considering this question. Our Company is participating in a group of utilities which is preparing legislation to amend Section 3 of the Act (your "approach two"). In responding to your questionnaire, I would like to briefly state this Company's position in support of the proposed amendments to Section 3 of the Act.

First, let me say that we believe a strong case could be made for outright repeal of the Act. The pyramiding schemes and securities manipulations which led to passage of the 1935 Act were corrected years, even decades, ago. Unlike the situation in 1935, today utilities are subject to extensive State regulation, SEC regulation of utility securities, and antitrust laws. In our opinion, this present-day panoply of State and Federal regulation fully protects ratepayers, stockholders and the public and obviates the need for the Act. The public knows about and has confidence in the State PUC, whereas it probably knows nothing about the SEC, at least insofar as utilities and PUHCA are concerned. We certainly perceive the public as having a strong preference for utilities being regulated at the State level rather than at the Federal level and believe that the public would view, and support, repeal of the Act as removing a layer of remote, unnecessary Federal regulation.

However, to us and our utility group the repeal approach just seems to be politically impractical, particularly in an election year. Congress is already involved in a number of major national issues. Outright repeal of the Act would become a significant, perhaps controversial, issue, and there will always be some resistence to repealing an entire Act irrespective of how outmoded it has become in the 46 years since its enactment. Repeal of the entire Act also would obviously take much longer to enact than would merely amending one section. For these reasons, we have concluded that the amendment approach is more feasible and should be pursued.

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The three proposed amendments, as set out in your questionnaire, would remove possible obstacles in Section 3 to diversification and, thus, would predictably lead to some limited diversification by some utilities. We firmly believe that these amendments and any resulting diversification would be in the public interest. It is well known that the utility industry has had serious financial problems for the last ten years, as evidenced by their common stocks selling below book value, declining coverages of interest expenses, lowered bond ratings, and severe difficulty in raising capital on reasonable terms. Although BG&E's allowed rate of return during this period has not been adequate, we have not even been able to earn the allowed return due to inflation, attrition, and regulation. Thus, we view diversification into unregulated non-utility businesses as a possible means to make our stocks and bonds more attractive in the financial marketplace. This would lower the cost of capital to our ratepayers, benefit our stockholders, and improve our competitive financial standing. We appreciate your interest in this subject and your determination to remove Federal barriers to improving the financial condition of utilities. We urge you to support the three proposed amendments to PUHCA as an effective means of obtaining this objective.

We trust that these general comments will be of some assistance to you in considering the subject of utility diversification and any PUHCA legislation that may be introduced. We would, of course, be pleased to provide any other information you may need.

Sincerely yours,

G. V. McGowan

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CP&L
Carolina Power & Light Company
P. O. Box 1551 • Raleigh, N. C. 27602
(919) 836-6382

SHERWOOD H. SMITH, JR.
Chairman/President

November 30, 1981

The Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington DC 20515

Dear Congressman Corcoran:

Thank you for your letter of October 27, 1981, concerning the relationship between electric utility diversification and the Public Utility Holding Company Act of 1935. This is in response to the questionnaire you enclosed.

We are grateful for your recognition of the very difficult financial condition of electric utilities, and your interest in providing ways in which electric utilities can become financially stronger. Such would benefit our consumers, as well, by helping to ensure adequate electric power in the future, by increasing the prospect for our nation to enjoy continuing progress in providing good jobs and an improved standard of living for all citizens. As you have evidently surmised, the potential benefits of diversification simply will not be feasible in a number of instances if the Holding Company Act remains in its present form as a deterrent.

APPROACH ONE addressed in your questionnaire encompasses legislative action that is much broader than we can envision as being needed by this company, since we are not subject to the Holding Company Act. Therefore, our company simply is not in a position now from which it is feasible to seek to measure the likely effects of APPROACH ONE.

However, APPROACH TWO does address a situation which CP&L might find applicable. We would be inclined to support the passage of legislation designed to accomplish the three areas outlined in APPROACH TWO.

Some utilities believe that the existing potential for diversification by them appears to be quite good. For a number of reasons, our company does not consider diversification as an immediate likelihood, but we are well aware that future events may make diversification feasible for us, and we expect to explore, as a continuing company activity, the diversification opportunities. There is no question but that the Holding Company Act, unless amended, would diminish our interest in investigating and pursuing such opportunities.

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To specifically address Question 1 under APPROACH TWO, the exemption of holding companies having only one public utility subsidiary (whose operations would be confined to the state of incorporation and contiguous states) appears to be by far the preferred structure for diversification from our viewpoint as an independent operating company. In that regard, eliminating the "unless and except" clause is essential. We would not expect to pursue diversification through a separate company if becoming subject to the Holding Company Act were to be the result. One reason is that we would constantly wonder whether, and when, we might have to sell, on a distress-sale basis, the non-utility operation. In addition, the potential of having to meet the additional regulatory requirements of a non-exempt company would clearly affect the feasibility of diversification. Thus, our answer to your first question under APPROACH TWO is that, while amending the Act as suggested would not automatically create opportunities for sound diversification, the failure to amend it would clearly inhibit the entry into sound diversification programs which might be feasible presently for some utilities, and which we hope will become feasible later for us.

As for Question 2, the proposed amendments should be received well by the parties you list, especially the utilities and their shareholders. State commissions and rate payers probably would approve provided it did not appear that assets needed and available for utility service might be diverted into other ventures and thus jeopardize future service. Sound diversification, conducted through a separate corporate structure such as implied by APPROACH TWO should be acceptable and could lead to an improved financial standing for many electric utilities. Such added financial strength should be welcomed by all four groups and should enable utilities to raise capital at lower costs.

Sincerely yours,

Sherwood H. Smith, Jr.

SHSjr/lac

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New England Electric

New England Electric System
25 Research Drive
Westborough, Massachusetts 01581
Tel. (617) 366-9011 TWX 710-390-0732
Cable: NEELECSYS WTBO

Guy W. Nichols
Chairman, President and
Chief Executive Officer

November 30, 1981

Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth HOB
Washington, D.C. 20515

Dear Congressman Corcoran:

I am writing on behalf of New England Electric System to respond to your questions regarding proposals to amend the Public Utility Holding Company Act of 1935.

New England Electric System (NEES) is an electric utility holding company system which, through its three distribution subsidiaries, delivers electricity to communities in Massachusetts, New Hampshire and Rhode Island. New England Power Company (NEP), NEES's generation and transmission subsidiary, sells power at wholesale to the NEES system distribution companies, and also makes interstate wholesale sales to other New England electric utilities.

The questions appended to your letter ask that we consider two approaches to amending the Public Utility Holding Company Act; the first would repeal the Act, and the second would broaden the exemptive categories and remove SEC administrative control over exempt holding companies. I would like to confine my response at this time to the questions which pertain to total repeal. As noted above, NEES is engaged in the public utility business through more than one operating subsidiary. Given our present corporate structure, we would not be eligible for exempt status as proposed in Approach No. 2.

Approach One: Repeal the PUHCA with provisions stating that such repeal would not affect any PUHCA proceeding previously commenced.

Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct? Please specify.

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Response:

The Congress that enacted PUHCA in 1935 faced the task of correcting the abusive practices of giant holding companies which controlled, in many cases, as many as 100 or more utility and non-utility businesses reaching into all geographic areas of the United States. The complexities of these structures enabled a small group of stockholders at the top of these elaborate pyramids to mask many forms of abusive practices including excessive encumbrances of utility assets, undercapitalization of securities issuances, watering the value of outstanding shares, and imposition of excessive charges on consumers through "sweetheart contracts" for the provision of management services by the holding companies to the utility subsidiaries.

These abuses, described in the Congressional findings in section 1 of the Act, compelled Congress to require the SEC to dismantle each of these systems, leaving intact a holding company system comprised only of those businesses necessary and incidental to the operation of a single geographically-integrated public utility system. To prevent recurrence of these abuses, Congress also gave the SEC comprehensive authority to review and approve or disapprove most of the financing, investment and affiliate transactions of a holding company system. The severity of these controls reflects the then-prevailing assumption that only constant federal scrutiny could prevent the natural tendency of holding company management to recreate the abuses of the past.

By 1952, the Act's mandate to the SEC to dismantle the holding company systems was largely accomplished through lengthy and complicated divestiture proceedings. Today, a utility holding company is a simple management device used to organize the business of a limited number of operating utility companies and, in some cases, diversified ventures that contribute a relatively small portion of the system's annual earnings. Nevertheless, the Act's pervasive system of regulatory controls over securities issuances and investment decisions continues to apply to a small number of registered holding company systems whose management must guide the course of corporate business and financing to accommodate regulatory delays and standards for business decision making set by the SEC.

In association with seven other registered electric utility holding companies, NEES supports a scheme for amending PUHCA that rests on the assumption that today's holding company management can be trusted both to protect the interests of its investors and to fulfill its service obligations to its customers. That scheme is set out in S. 1869, which was

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introduced on November 19 by Senators D'Amato and Johnston. The SEC's command control authority over securities issuances, which subjects basic corporate decision making to the overriding judgment of the SEC, would be changed to provide a fail-safe mechanism by which the securities issuances would be automatically effective unless the SEC, within a specific review period, determines that the issuance involves an unsound financial practice. Comparable to the case of securities issuances, the SEC would retain a fail-safe authority to correct an improvident diversification decision: the SEC would retain authority to seek divestiture of a non-utility business, based on factual determinations that the business was material to the holding company's business, and its retention would be detrimental to the interests of investors or consumers. We believe these amendments represent a sensible and entirely justified intermediate step to repeal.

It is clear that circumstances have changed dramatically and irreversibly from those which characterized the utility industry in the first part of this century. Indeed, the Congress may well conclude that the array of existing state and federal rate regulatory powers, coupled with the evolution of professional standards in the accounting profession and the high degree of investor protection achieved under the nation's securities laws, more than suffice to safeguard the public interest. PUHCA may now be entirely anachronistic.

Question 2: To what extent would federal and state law adequately protect the interests of stockholders and ratepayers were PUHCA to be repealed?

Response:

The Federal Power Act, enacted at the same time as PUHCA, empowers the Federal Energy Regulatory Commission (FERC) to regulate the transmission of electric energy in interstate commerce, as well as the sale of electric energy at wholesale (i.e. for resale), in interstate commerce. The same Act gives FERC jurisdiction over all facilities for such transmission and sale. NEP, as a wholesale generation and transmission company, is therefore subject to comprehensive regulation by FERC with regard to essentially all aspects of its business, including the allocation of costs between utility and non-utility businesses for purposes of cost-based ratemaking. The Massachusetts, Rhode Island and New Hampshire Commissions regulate the rates of NEES distribution companies within their respective jurisdictions. Repeal of the PUHCA will not affect the authority of FERC and the state commissions to protect the interests of consumers in executing their respective ratemaking responsibilities.

Moreover, it should be emphasized that repeal of PUHCA will

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not leave the assets of utility companies vulnerable to ill-conceived disposition or to excessive encumbrances arising from issuances of securities or other assumptions of liability. Under sections 203 and 204 of the Federal Power Act, the FERC has authority to review and approve any significant disposition of utility assets, as well as the securities issuances and assumptions of liability by utilities subject to the FERC's ratemaking authority. The FERC must review and approve the disposition of utility assets unless the disposition is subject to review by the SEC under PUHCA. And, the FERC must review and approve securities issuances and assumptions of liability by a jurisdictional company such as NEP, unless that financing activity is subject to review by the SEC under PUHCA, or by a state agency granted authority to regulate such issuances by utilities organized and operating within that state. In the case of NEP and the other NEES operating companies, issuances, as well as acquisitions, of securities are subject to approval by state commissions in their respective states of organization and operation.

In addition, NEES companies are subject to the rules governing securities registration, trading and investor disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934. Thus, NEES' investors enjoy the same substantial protections afforded investors in all other publicly-traded corporation.

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

Response:

As pointed out above, NEES operating companies are subject to regulation of their rates and financings by FERC and/or state commissions. This regulation would survive repeal of PUHCA. Nor does there appear to be any prospect of conflict developing between the states as a result of such repeal. FERC regulation, of course, preempts state regulation of matters relating to interstate transmission and wholesale sale of power and therefore precludes any conflict with regard to such matters.

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

Response:

The combined state and federal authority to regulate the rates charged and securities issued by public utilities, to

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enforce tariffs and service obligations and safeguard the encumbrance of utility assets--all powers which would continue in effect even if PUHCA were repealed--are quite sufficient to protect the public interest in maintaining adequate and reliable utility operations. Whether the public has confidence that this is so is not known. That it is so we believe can be demonstrated to the satisfaction of the Congress should the opportunity be presented.

Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

Response:

The repeal of PUHCA would free utility management from unnecessary and largely duplicative regulatory burdens. To the extent that utility management, left to its own business judgment, were to conclude that it could usefully and profitable engage in non-utility ventures, one can expect that the removal of constraints contained in PUHCA would lead to greater diversification than might otherwise occur. However, in our opinion, utility shareholders and ratepayers are likely to be better off than under the existing system of controls. Diversification provides a meaningful opportunity to improve and tone management strength, to buttress investor interest in utility stocks and to improve the financial circumstances of the electric utility industry. Let me hasten to add that diversification is not a "solution" to the financial crisis which confronts the electric utility industry. Only responsible administration of rate regulatory powers and prudent business planning on the part of electric utilities will extract the industry from its current difficulties. Diversification, however, provides an important opportunity to improve financial conditions.

Let me conclude by expressing my appreciation for your interest in this matter. I would be pleased to discuss these issues in greater detail should you desire.

Sincerely

Henry W Becker

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AMERICAN ELECTRIC POWER *Company, Inc.*

AEP

180 East Broad Street, Columbus, Ohio 43215
(614) 223-1000

W. S. WHITE, JR.
Chairman of the Board
and
Chief Executive Officer
(614) 223-1500

November 30, 1981

Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

I am responding on behalf of the American Electric Power System to your letter of October 27th relating to proposed amendments to the Public Utility Holding Company Act of 1935 (the "1935 Act").

American Electric Power Company, Inc. and its eight electric utility subsidiaries constitute a registered holding company subject to regulation under the 1935 Act. The service area of the AEP electric utility subsidiaries covers portions of the states of Ohio, Indiana, Michigan, Virginia, West Virginia, Kentucky and Tennessee. The AEP utilities consist of Appalachian Power Company, Columbus and Southern Ohio Electric Co., Indiana & Michigan Electric Company, Kentucky Power Company, Kingsport Power Company, Michigan Power Company, Ohio Power Company and Wheeling Electric Company. These companies provide electric service to nearly 2,500,000 customers.

Your letter put forth for discussion two legislative approaches. The first concerned possible repeal of the 1935 Act and the second proposed broadened exemptions for holding companies which are exempt from the provisions of the 1935 Act. Since AEP is a regulated public utility system and is not exempt from the 1935 Act, I would propose to restrict my comments to the first legislative approach.

Question 1 under this approach inquired as to whether utility companies continue to present the problems of size and structural complexity that the 1935 Act was intended to correct.

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I believe this goal of the 1935 Act has been long achieved for all of the remaining registered holding company systems. For example, the AEP System has a simple corporate structure consisting of a non-operating holding company, eight directly owned operating utilities which, in certain instances, have coal mining subsidiaries of their own, and a service corporation which is also directly owned by the parent holding company and which renders at cost engineering, accounting, financing and other services to the operating utilities.

Question 2 concerned the extent to which federal and state laws would protect the interests of stockholders and ratepayers if the 1935 Act were repealed. It is clear that since 1935 the Federal Power Commission (now the Federal Energy Regulatory Commission) and the state commissions have assumed much greater strength and power and have largely occupied the void that the 1935 Act was intended to fill. Moreover, the Securities Act of 1933 and the Securities Exchange Act of 1934 have expanded to a scope not envisioned at their enactment so as to provide adequate protection to shareholders. Nonetheless, it is my belief that complete repeal of the 1935 Act is neither necessary nor appropriate. The 1935 Act does serve to regulate the holding company system as a whole, rather than as disparate entities, particularly in the important area of intercompany transactions. Therefore, it would seem more appropriate at this time simply to modernize certain of the provisions of the 1935 Act so as to eliminate unnecessary duplication of regulatory burdens. Such actions could productively be taken in the area of financing. In addition, the 1935 Act could be amended to allow regulated companies the same opportunity to diversify into non-utility functions as is afforded utilities not subject to the 1935 Act.

Questions 3 and 4, respectively, sought to determine whether repeal of the 1935 Act would result in conflicting state regulation and whether public confidence in the state commissions is sufficient to reduce the federal role in regulation of local utilities. Under such circumstances, the state commissions should, in my opinion, continue to exert regulation over a local utility without serious conflicts arising. However, it should be recognized that some conflicts might result in commission review of transactions with non-regulated and out-of-state subsidiaries. In addition, the public interest

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is sufficiently protected on the state level so as to permit the reduction of regulation on the federal level. The major focus of the public has been centered on rate regulation -- an area in which the 1935 Act is not involved. Consequently, the public confidence should not be affected if the 1935 Act were repealed or amended. This should particularly be the case if amendment of the 1935 Act is undertaken in the areas of financing and diversification since these subjects have not generally been of significant interest to the public.

Finally, Question 5 asked the impact that repeal of the 1935 Act would have on the state commissions, the utilities, stockholders, and ratepayers. I believe the state commissions and stockholders benefit from the overall review of the holding company system exercised by the Securities and Exchange Commission under the 1935 Act. Such review is particularly useful in the area of intercompany and affiliated transactions. Consequently, repeal of the 1935 Act would not result in a clearly favorable impact. However, if the 1935 Act were simply amended to eliminate unnecessary regulatory burdens in financing and to permit diversification, this action should be deemed to be clearly beneficial to all parties. In my opinion, diversification would most likely develop in fields allied or associated with the utility business such as fuel and transportation. The more efficient and profitable use of such assets already in place for utility purposes should serve to benefit both ratepayers and stockholders. However, it is unrealistic to expect the relatively small scope of business activity represented by diversification to cure the basic and fundamental financial problems of the utility industry.

I appreciate your concern about the utility industry and wish to thank you for the opportunity to respond to your questions.

Very truly yours,

W. S. White, Jr.

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Houston Industries Incorporated

D. D. Jordan
President and Chief Executive Officer

November 30, 1981

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The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Congressman Corcoran:

Thank you for your letter of October 27, 1981 regarding the impact on the utility industry of the Public Utility Holding Company Act of 1935. Although, as you noted in your letter, Houston Industries is an "exempt" holding company for purposes of the 1935 Act, it is very directly affected by the general financial health of the electric utility industry. Our principal operating subsidiary, Houston Lighting & Power Company, expects to spend an average of more than $1 billion a year throughout the 1980's for capital construction to meet the growing needs of our service area. At least two-thirds of this amount will have to be financed through external sources. Accordingly, the perception of the electric utility industry in the capital markets is a matter of major concern to us.

In response to your specific questions, it is our impression that the pyramiding schemes and other abuses that the 1935 Act was intended to correct are problems of the distant past. To our knowledge, there have not been any holding company structures with these undesirable characteristics for more than 30 years. The continuous reporting system established under the Securities Exchange Act of 1934, the registration system under the Securities Act of 1933 and the enforcement powers vested in the Securities and Exchange Commission all provide ample protection of the interests of stockholders of public utility holding companies. Similarly, the plenary jurisdiction of the state commissions over transactions between regulated utilities and their non-utility affiliates provides ample protection of the interests of ratepayers. From our

P.O. Box 1700, Houston, Texas 77001 (713) 228-2474

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perspective, the 1935 Act represents a duplicitous and unnecessary layer of regulation upon an important segment of our industry. It also discourages the rest of us from attempts at diversification that could be beneficial to stockholders and ratepayers alike. We believe, therefore, that outright repeal of the 1935 Act would be very much in the public interest.

For the most part, the consuming public in our service area is not aware of a federal role in the regulation of local electric utilities, at least insofar as the 1935 Act is concerned. To the extent that the public perceives any activity at the federal level, it is generally that of the Federal Energy Regulatory Commission under different and unrelated legislation. We understand that the SEC's Division of Corporate Regulation, which administers the 1935 Act, currently has a professional staff of less than 10 individuals. From the point of view of consumers, this hardly constitutes a "federal role" in the regulation of local utilities. Thus, repeal of the 1935 Act would not, in our judgment, result in any diminution in the public's confidence in either state or federal regulation.

You have asked to what extent, if any, repeal of the 1935 Act or removal of the "unless and except" clause would lead to utility diversification. We at Houston Industries certainly do not foresee any rush to expand into other businesses, particularly in view of the demands currently being placed upon our financial and managerial resources. It is possible, however, that opportunities would present themselves which have heretofore passed us by because of the 1935 Act. If such an opportunity should arise which (a) holds out the prospect of materially improving the market price for our common stock (from which our ratepayers would benefit through reduced costs for construction financing) and (b) involves a situation that would not dilute or divert our present management from its responsibilities to utility operations, then we would owe an obligation to both our stockholders and our ratepayers to take advantage of that opportunity.

On behalf of Houston Industries Incorporated, I want to thank you for allowing us to express our views on this matter. Please do not hesitate to contact me if I may be of further assistance.

Sincerely yours,

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R. Dean Westervelt
Senior Vice President

CILCO
Central Illinois Light Company
300 LIBERTY ST. / PEORIA, ILL. 61602

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The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Corcoran:

Mr. Feltenstein has been out of the city and has asked me to reply to your letter of October 27.

It is my understanding that Senators D'Amato and Johnston introduced Public Utility Holding Company Act legislation, S.B. 1870, within the past two weeks.

We further understand that this proposed legislation would encompass the second legislative approach outlined in your letter. We are a part of a utility group that suggested this legislation, and we support this approach.

In our opinion, if legislation was passed to exempt holding companies, we believe that most single utility companies like CILCO would approach this with caution. Secondly, it would be necessary for the state PUCs to develop a series of definite rules and regulations to handle these situations fairly and equitably.

We certainly appreciate your interest in possibly removing Federal statutory and regulatory barriers that may inhibit single public utilities from diversifying.

Sincerely,

RDW:sdj

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HAWAIIAN ELECTRIC COMPANY, INC.
Box 2750 Honolulu, Hawaii 96840

PETER C. LEWIS
VICE PRESIDENT ADMINISTRATION
AND SECRETARY

December 1, 1981

The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Representative Corcoran:

This is in response to your letter of October 27, 1981 to Carl Williams, former President of Hawaiian Electric Company.

Hawaiian Electric Company, Inc., is a holding company within the meaning of the Public Utility Holding Company Act of 1935 ("PUHCA"), but is exempt under Section 3(a) because the holding company and its utility subsidiaries are predominantly intrastate in character.

In such a situation, the regulation by the State Public Utilities Commission of the utility activities is sufficient to protect the interest of the ratepayers and the stockholders, in our opinion. In Hawaii, the State Public Utilities Commission also has sufficient jurisdiction in the area of diversification.

Therefore, an amendment of the PUHCA to permanently exempt each holding company and each subsidiary company thereof which is a public utility company (irrespective of the number of subsidiaries) and which are predominantly intrastate in character would eliminate unnecessary federal government regulation.

Sincerely,

Peter C. Lewis

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PUGET SOUND POWER & LIGHT COMPANY

PUGET POWER BUILDING - (206) 454-6363
BELLEVUE, WASHINGTON 98009

December 2, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D. C. 20515

Re: The Public Utility Holding Company Act of 1935

Dear Congressman Corcoran:

Thank you for your letter of October 27 and the opportunity to comment upon the possible repeal or amendment of the Public Utility Holding Company Act of 1935 (the "Act").

As you are undoubtedly aware, the regulatory burden on investor-owned electric utility companies has become particularly acute in recent years. Consequently, we share and appreciate your interest "in the possibility of removing federal statutory and regulatory barriers that may inhibit the ability of utilities to financially help themselves and their stockholders and ratepayers." We understand from your letter that you are considering the possible repeal or amendment of the Act as a step toward removal of these barriers.

Although Puget Sound Power & Light Company ("Puget") is not presently part of holding company system subject to the Act, Puget shares the interest of several utility companies in following the course of legislative proposals aimed at changing the Act. The holding company structure is conducive to diversification because it permits separation of various businesses for liability, rate-making and other purposes. However, the Act constitutes a substantial impediment to diversification through the holding company structure.

Although the first legislative approach outlined in the discussion paper enclosed with your October 27 letter (i.e., repeal of the Act) would obviously remove this impediment, our comments are limited to what we consider to be the most important aspect of the second approach, namely amendment of section 3 of the Act to remove the "unless and except" clause. Because Puget's service areas are located entirely within the state of Washington, a holding company structure adopted by Puget for diversification purposes should be eligible for an exemption under section 3(a)(1) or (2) of the Act. Consequently, amendment of section 3 to

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provide exemptions for certain holding companies with only one public utility subs iary and holding companies created by companies that are presently exempt under section 3(a)(2) of the Act would not have an immediate impact on Puget's present or prospective future operations.

On the other hand, amendment of section 3 to remove the "unless and except" clause appears to be a prerequisite to Puget's diversification through a holding company structure. Puget views the "unless and except" clause as a substantial and unnecessary barrier to diversification through the holding company structure. Section 3 of the Act requires the SEC to exempt certain types of holding companies and their subsidiaries "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers." The SEC may rely upon the "unless and except" clause to revoke a previously granted exemption. The risk and consequences of revocation of an exemption for a diversified electric utility company cannot be ignored.

For example, Puget in the past has been presented opportunities for diversification into businesses that are not functionally related to its electric utility business. However, the SEC has interpreted the policy statement in section 1(b)(4) of the Act and the "other business" clauses of section 11(b) (1) as permitting a holding company system to engage only in those businesses which are functionally related to its public utility business. For an exempt company, diversification into businesses that are not functionally related to its public utility business may be cause for revocation of the exemption on the basis of the "unless and except" clause. Revocation of the exemption would most likely result in the forced divestiture of those businesses which are not functionally related to the utility business, thereby defeating the very objective to be facilitated by adoption of the holding company structure.

Removal of the "unless and except" clause would relieve a strong chilling effect of the Act on certain diversification opportunities being considered by Puget. Such removal should not have an adverse effect on the Washington Utilities and Transportation Commission or on Puget's stockholders and ratepayers.

In summary, we applaud your concern over the financial plight of electric utility companies in today's regulatory environment and wish to encourage your efforts to remove federal statutory and regulatory barriers that inhibit the ability of utilities to improve their financial performance through diversification. Repeal or amendment of the Act in the manner described in your October 27 letter is certainly a step in the right direction.

If we can be of any further assistance in this regard, please do not hesitate to contact us.

Sincerely yours,

Neil L. McReynolds
Vice President
Corporate Relations

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EUA

Eastern Utilities Associates

99 High Street, Suite 2830, Boston, Massachusetts 02110 Telephone (617) 357-9590
Address all correspondence to P.O. Box 2333, Boston, Massachusetts 02107

December 3, 1981

Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth HOB
Washington, D.C. 20515

Dear Congressman Corcoran:

I am pleased to reply on behalf of Eastern Utilities Associates to your letter of October 27 concerning the utility industry and proposals for changes in the Public Utility Holding Company Act of 1935 (PUHCA). I appreciate very much your interest in this matter.

As you probably know, Eastern Utilities Associates (EUA) is one of the utility holding companies registered under the PUHCA. It has two direct subsidiaries which are electric utility companies selling electricity at retail, one of these being Eastern Edison Company, organized and operating in Massachusetts, and the other being Blackstone Valley Electric Company, organized and operating in Rhode Island. An indirect subsidiary of EUA, Montaup Electric Company, is a Massachusetts corporation wholly owned by Eastern Edison Company and is in the business of generating, purchasing and transmitting electricity, which it sells only at wholesale, to Eastern Edison Company, Blackstone Valley Electric Company, and several unaffiliated utilities. In addition, EUA has a service company as a direct subsidiary which at the present time engages principally in providing various services to the other companies in EUA's holding company system.

The discussion paper enclosed with your letter deals first, as Approach One, with repealing the PUHCA, and it presents five questions under that approach. I have read the responses made to those questions in the letter of November 30, 1982 to you from Mr. Guy W. Nichols of New England Electric System. That system, though several times larger than EUA, strongly resembles the EUA holding company system both in its structure and with respect to the federal and state regulatory authorities to which it is subject. EUA is one of the seven electric utility holding companies mentioned in Mr. Nichols' letter as supporting amendments to the PUHCA embodied in S.1869 introduced on November 19th. Mr. Nichols' responses coincide so nearly with those which I would make that I think it would not be useful for me to set forth here a separate statement of my own views. Instead, I ask that you permit me to be recorded as concurring in those expressed in Mr. Nichols' letter.

Since Approach Two deals with exemptions for which EUA would not qualify, I think it appropriate for me to refrain from commenting on that approach.

Yours very truly,

John F. G. Eichorn, Jr.
President

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PUBLIC
SERVICE
INDIANA

Hugh A. Barker
Chairman and
Chief Executive Officer

December 3, 1981

Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

In reply to your letter of October 27 with the attached questionnaire concerning the two legislative approaches to the Public Utility Holding Company Act of 1935 (Act), our Company has not had any experience with the Act since the late 1940s when the holding company of which we were a part was broken up. Therefore, our reply to your questions will have to be general.

APPROACH ONE.

Question 1. At the present time the problems of size and structural complexity the Act was intended to correct do not appear to be problems. Holding company systems have been integrated and, under present economic conditions, there have been no recent tender offers for the stock of independent operating companies, and due to the present unfavorable financial conditions of electric utilities, future tender offers are most unlikely. This is not to say that if the economics of electrical utilities were to improve to a marked degree, that tender offers would not be made for independent operating companies either on an integrated or non-integrated basis. In Indiana, there is only one electric subsidiary of a holding company, namely, Indiana & Michigan Electric Company. While construction and operating procedures of I&ME are largely based upon the integrated AEP system, the operation of I&ME in Indiana is quite similar to that of an independent electric utility. With respect to size, in these times of ever increasing expenses, a case can be made for merging, consolidating or placing under a holding company operating companies in order to save expenses resulting from larger scale and thereby reducing electric rates. Structural complexity

1000 East Main Street, Plainfield, Indiana 46168 317 838 1242

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can be controlled, as far as Indiana is concerned, by the Public Service Commission and at the Federal level by the Federal Power Act and the Securities Act of 1933.

Question 2. The recent situation in Wisconsin, where the Wisconsin Public Service Commission has asserted jurisdiction over proposals by Wisconsin Power & Light Company and Wisconsin Electric Power Company to reorganize to facilitate diversification, demonstrates that at least one state regulatory commission has determined that it has authority over the formation of holding companies. The SEC has apparently deferred action on the companies' applications for exemption under the Act. While there are no clear cut precedents for such action in Indiana, it must be noted that the Indiana Public Service Commission Act was patterned after the Wisconsin act. In our opinion, the existing Federal and State laws would adequately protect the interests of stockholders and ratepayers. To confirm this, however, legal research would have to be done.

Question 3. In our opinion, the repeal of the Act would not result in conflicting Indiana regulation and would not affect the public interest.

Question 4. If reduction of Federal regulation is confined to repeal of the Act, in our opinion, the public would have the necessary confidence in the Public Service Commission (Indiana Commission).

Question 5. Repeal of the Act might put an additional work burden on the Indiana Commission if, as in Wisconsin, the Commission assumed jurisdiction over diversification. With respect to the utilities, it might allow them to integrate and/or diversify more easily, depending on the reaction of the Indiana Commission. To the extent integration and/or diversification improved the financial picture of utilities, this would tend to improve the lot of shareholders. So long as we have ratemaking under the jurisdiction of the Indiana Commission for retail customers and under the Federal Energy Regulatory Commission (FERC) for wholesale customers, it is difficult to see how ratepayers would be affected by repeal of the Act.

APPROACH TWO.

Question 1. This amendment in and of itself will not lead to utility diversification. It will make it easier to diversify within the parameters of the amendment. Diversification for the sake of diversification is meaningless. It must be based upon sound economics and must hold out the attraction of greater earnings than can be made in the utility business.

Question 2. The amendment might put some additional burdens on the Indiana Commission depending upon the extent to which they can take jurisdiction over the diversification. The amendment would make it somewhat easier for the utilities to diversify within the parameters of the amendment. Repeal of the "unless and except" clause would assure the exempt companies that their exemptions would not be revoked and avoid the risk that diversification, if objected to after the fact by the SEC, could result in their being subject in full to the 1935 Act. To the extent diversification within the parameters of the amendment improved the financial picture of utilities, this would tend to improve the lot of the stockholders. So long as we have ratemaking under the jurisdiction of the Indiana Commission for retail customers and under FERC for wholesale customers, it is difficult to see how ratepayers would be affected by the proposed amendment.

Yours truly,

Hugh A. Barker

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TEXAS UTILITIES COMPANY
2001 BRYAN TOWER · DALLAS, TEXAS 75201

BURL B. HULSEY, JR.
CHAIRMAN OF THE BOARD

December 4, 1981

The Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, DC 20515

Dear Congressman Corcoran:

This is in response to your letter concerning possible amendments to the Public Utility Holding Company Act of 1935 (the Act).

As you know, the Act was passed in an attempt to correct a number of perceived abuses which had occurred in the utility business, notably excessive pyramiding of corporate structures and stock watering. At least partly as a result of the Act, as well as other state and federal legislation such as the Securities Act of 1933, those abuses are unlikely to recur.

As you pointed out, the electric utility industry in the United States is experiencing serious financial difficulties, despite frequent rate increases that have concerned consumers. It is difficult to raise the required capital on reasonable terms and most electric utility stocks sell at far below their book value. An apparent possible solution would be to allow utilities to diversify into more profitable non-utility business. Successful diversification could make the companies' securities more attractive investments, thereby reducing the cost of raising capital and benefiting investors and consumers.

The Act presents one impediment to such diversification even in the case of a company such as Texas Utilities Company, which is exempt from the Act under Section 3(a)(1). More specifically, the "unless and except" clause of Section 3 may allow the Commission to review diversification efforts in hindsight and possibly to revoke an exemption based on that review. If an exemption were revoked, a utility could be subject to the forced divestiture of the non-utility business as well as the additional regulation imposed by the Act upon registered holding companies. Obviously this element of uncertainty tends to restrict utility managements from undertaking significant diversification efforts. We are most interested in removing this uncertainty by the statutory elimination of the "unless and except" clause.

Since there are relatively few utility companies which have decided to undertake a diversification program and since the Act is only one element to be considered in such a decision, it is difficult to conclude definitively that amendment of the Act will lead to greater diversification. It appears, however, that the removal of this particular impediment could encourage diversification and thereby benefit customers and stockholders.

We appreciate your concern for the financial integrity of our industry.

Sincerely,

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Central and South West Corporation
2700 One Main Place • Dallas, Texas 75250 • 214-745-3703

DURWOOD CHALKER
Chairman and Chief Executive Officer

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December 4, 1981

Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth HOB
Washington, D.C. 20515

Dear Congressman Corcoran:

I sincerely appreciate the opportunity, on behalf of Central and South West Corporation, to respond to your recent letter wherein you sought our views on the Public Utility Holding Company Act of 1935 ("PUHCA").

Central and South West Corporation (CSW) is a registered electric utility holding company under PUHCA, and owns all of the outstanding common stock of four operating subsidiaries which, in turn, provide electric service to approximately four million people in Texas, Oklahoma, Louisiana and Arkansas. Regulatory commissions in these four states exercise jurisdiction over the retail rates and operations of our operating subsidiaries, and the Federal Energy Regulatory Commission also has jurisdiction under the Federal Power Act over certain System facilities and operations. As you are aware, the Securities and Exchange Commission has, in addition to its extensive authority under PUHCA, authority over CSW regarding securities registration, trading and investor disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The questions accompanying your letter requested us to comment on two possible legislative options regarding PUHCA. Your second option would broaden the categories of exemptions

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available to those public utility holding companies which are presently exempt from registration under PUHCA. Since CSW is a registered holding company, I must confine my responses to your questions on Approach One, that is, repeal of the present law.

Approach One

Question 1: To what extent, if any, do utility companies continue to present the problems of size and structural complexity the Act was intended to correct? Please specify?

Response: The problems of giant holding companies with complex intercorporate structures which had developed by the 1930's simply do not exist anymore. Within 20 years of its enactment, the Congressional mandate of PUHCA to reorganize and simplify the holding companies had been substantially completed by the SEC. In today's environment a registered utility holding company is a highly regulated but relatively simple corporate management device which seeks to coordinate the activities of a small number of operating companies. Unlike the era of highly leveraged and undercapitalized financial structures, utility holding companies strive to maintain economically optimum capital structures with appropriate levels of equity. While the SEC's regulatory authority under PUHCA eliminated such abuses, the capital markets have become so competitive and the securities registration and disclosure requirements so pervasive that holding company shareholders now enjoy the same protections afforded investors in all publicly held enterprises, with or without PUHCA.

Question 2: To what extent would federal and state law adequately protect the interests of stockholders and ratepayers were PUHCA to be repealed?

Response: I have already cited several other Federal laws and regulatory schemes in addition to PUHCA which presently serve to maintain the proper balance between, and therefore simultaneously protect, the interests of stockholders and ratepayers. At the state level, regulatory commissions have the authority to set the retail electric rates for customers of CSW's operating subsidiaries. Such commissions have exercised

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their powers through the ratemaking process to address issues such as allocation of costs between affiliates and between utility and non-utility interests to protect the interests of consumers and investors alike.

It is important to remember that PUHCA was passed by Congress in 1935 immediately following enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. Taken as a whole, this legislation, enacted in the aftermath of the stock market crash of 1929, granted the SEC extraordinary powers over publicly traded corporate stocks. Obviously, the securities registration, trading, and disclosure requirements of the 1933 and 1934 Acts have had far broader impacts upon the capital markets than has PUHCA in terms of providing the general investing public with adequate information, and therefore, protection. Shareholders in CSW stock are afforded the same protection under these laws.

Question 3: Would the repeal of PUHCA result in conflicting state regulation? To what extent, if any, would this affect the public interest?

Response: In my judgment, the existence of PUHCA in truth has no effect on the question of conflicting state regulation since such conflicts can readily arise with or without PUHCA. At the time PUHCA was enacted, state regulation of utilities generally was scattered and essentially ineffective. Today, state regulation of utility rates and operations is the focus of public attention and has, in many instances, become highly sophisticated.

Question 4: Does the public have enough confidence in their state PUCs to reduce the federal role in regulation of local utilities?

Response: As I mentioned earlier, the state regulatory arena has become the focus of considerable public attention in recent years. Where the activities of state commissions and the SEC overlap or are duplicative, i.e., security issuance, diversification, and intercompany transactions, there is no apparent lack of public confidence in local regulation.

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Question 5: In your opinion, how would repeal affect your state PUC, the utilities, stockholders, and ratepayers? In particular, to what extent, if any, would repeal of PUHCA lead to diversification?

Response: In our opinion, repeal or modification of PUHCA would have no adverse effect upon state regulation, utilities, stockholders or ratepayers. In fact, we strongly believe that relief from unnecessary and duplicative regulatory burdens would definitely be in the public interest in that it would allow utility holding companies to compete more efficiently and effectively for capital, human and technical resources, and other free enterprise opportunities. With respect to diversification, I would hope that the opportunity to carefully and prudently diversify would allow us to strengthen our respective financial and business positions, thereby benefiting our shareholders and our customers.

Again, let me commend you for your interest and efforts in this matter. Naturally, we will be greatly interested in any Congressional activity affecting the Holding Company Act.

Sincerely,

Durwood Chalker

Durwood Chalker

DC:ck

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OHIO EDISON COMPANY
76 SOUTH MAIN STREET, AKRON, OHIO 44308 · 216 384 5844

J T ROGERS JR
PRESIDENT

December 8, 1981

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DAN'S NOTES:

The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Corcoran:

Your concern to foster the ability of utilities to help their investors and ratepayers is greatly appreciated. This letter is in response to your letter of October 27, 1981, respecting the Public Utility Holding Company Act.

Ohio Edison is a holding company subject to regulation under the Act although exempt since 1979 under Section 3(a)(2). Its utility operations are in Ohio. Operations of its utility subsidiary, Pennsylvania Power Company, are in the contiguous state of Pennsylvania.

One constraint on exploring diversification is Section 11(b) of the Act, contemplating that activities as an integrated public utility system should be limited "to such other businesses as are reasonably incidental to, or economically necessary or appropriate to the operations of such integrated public utility system". This Section is not an absolute barrier, but it tends to restrict exploration of options at a time when utilities should be encouraged to be resourceful in bettering their circumstances. Certainly, decisions to diversify will be dependent upon many complex factors; the opportunity to diversify, however, should not be denied because of the continued existence of a law that has in all probability outlived its usefulness.

Both of the approaches contained in the discussion paper attached to your letter would remove the constraints now presented by the Holding Company Act. Repeal would obviously have this effect, as would, in our case, amendment of the Act to remove the "unless and except" clause of Section 3(a). If, as has been widely suggested, the principal unique tasks for which the Act was created have been accomplished, and other Federal and State laws adequately protect investors and ratepayers, repeal of the Act would seem to offer the preferable solution.

Very truly yours,

Justin Rogers

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CENTRAL ILLINOIS PUBLIC SERVICE COMPANY
GENERAL OFFICES 607 EAST ADAMS • SPRINGFIELD, ILLINOIS 62701 • 217/523-3600

December 8, 1981

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Hon. Tom Corcoran
U. S. Representative
1107 Longworth Office Bldg.
Washington, D.C. 20515

Dear Tom:

This letter will respond to your correspondence of October 27, 1981 regarding the Public Utility Holding Company Act of 1935. We would like to express our appreciation for the opportunity to once again comment on a matter of interest to our Company and apologize for not getting back to you by November 25. However, we touched base with Al Cobb who informed us we still had plenty of time to submit comments.

We also wish to commend you for the attention you have given to this sensitive issue. We understand you have spent many hours listening to presentations of interested groups, even though it meant you had less time to devote to other matters. Please believe me when I say that we appreciate your efforts.

As you by now are aware, the utility industry is not entirely agreed on which, if any, strategy to pursue concerning possible changes to the Act. With respect to your questionnaire, we will address "Approach One" and "Approach Two" separately and conclude with a few general comments.

"Approach One" suggests outright repeal of the Act with the exception of any proceedings already underway. While we may agree with this approach in principle, we would suggest it might be politically impractical and publicly unpopular. From a philosophical perspective, we would agree that local government, i.e., the Illinois Commerce Commission and other state regulatory and enforcement agencies are capable of establishing and administering programs which would accomplish the objectives of the Holding Company Act. There are, of course, other regulatory constraints available to FERC and the anti-trust division of the Department of Justice.

If the Holding Company Act was repealed in its entirety, we don't believe there would be a noticeable difference in the status quo. We believe current state and federal law other than the Holding Company Act is sufficient to protect the public, ratepayers and shareholders.

You ask whether the public has enough confidence in state PUC's to reduce the federal role in regulation of local utilities. Even though the public may not have total confidence in the ability of state PUC's to

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administer federal programs, we believe the public has even less confidence in federal regulators. Given the opportunity to choose, we believe the public would opt for local administration.

Nevertheless, as stated earlier, we don't feel that total repeal of the Act would be acceptable from a political or public point of view even though it may be both desirable and justified. On this point, we would defer to your judgment.

"Approach Two", amending Section 3 of the Act to eliminate the "unless and except" clause, would seem to be more acceptable and we would support such an approach. As you know, our Company has been working with a group of other companies represented by the law firm of Reid & Priest. "Approach Two" is virtually identical to the position proposed by this group.

We support "Approach Two" because it addresses in a very specific manner a major impediment to utility diversification. The two remaining provisions of Approach Two (the contiguous states and one subsidiary) also cut right to the heart of the problem. In our opinion, this "rifle shot" attack would eliminate the problems facing those companies who may wish to diversify, and is much preferable to either repealing the Act or introducing three or four bills with varying remedies.

While we endorse and support the concept of "Approach Two", we want to make it clear that our company has no immediate plans for diversifying. We have studied diversification in the past and would expect to continue doing so. However, as long as providing reliable electric and gas service remains a viable business purpose -- which we believe it does -- we plan to continue doing what we know how to do best. It is for this reason amending the Act is not currently one of our top legislative priorities.

Obviously, if political wisdom dictates that now is the opportune time to achieve changes to the Act, we will support the effort on the basis that such change may be of use to us at some point in the future.

For those companies wishing to diversify into nonregulated businesses, we would agree that the holding company structure is the preferable organizational form. It serves to mitigate problems arising from forced cross subsidization between the regulated and diversified sides of a business.

In conclusion, we support the move to eliminate existing impediments to increased utility diversification as outlined in Approach Two, even though passage of such an amendment would not necessarily result in a move toward diversification by our company in the foreseeable future.

We hope our comments will be of some use to you in analyzing and developing a final position on this significant issue. If we can be of any further assistance, please don't hesitate to call.

Again, thank you for the opportunity to comment.

Sincerely,

Ken

Kenneth L. Andres, Manager
Public Affairs Department

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Wisconsin Power & Light Company
Investor-owned Energy
222 West Washington Avenue P. O. Box 192 Madison, Wisconsin 53701 Phone 608/252 3311

DATE AR'D: DOC #:
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DAN'S NOTES

December 9, 1981

EXECUTIVE OFFICES

The Honorable Tom Corcoran
U. S. House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

We appreciate the opportunity to respond to your letter of October 27 wherein you ask for our comments to two legislative approaches at amending the Public Utility Holding Company Act of 1935.

Wisconsin Power and Light Company would generally favor Approach Two outlined in your letter of October 27, 1981. The question presented is how best to accommodate diversification with regulation of public utility operations. It is, of course, essential that utility operations and accounting should be wholly separate from and insulated to the extent possible from nonutility operations. This can best be accomplished by an exempt holding company with separate and distinct corporate subsidiaries.

The removal of the "unless and except clause" is significant in providing management with incentive to diversify. If an exemption is lost under that clause, the holding company may be required to divest one or more subsidiary businesses, or subjected to additional and burdensome regulation.

Enactment of Approach Two, absent overreaction by state regulators, would facilitate diversification. More importantly, it would provide incentive to accomplish diversification through a holding company structure. This structure provides the best opportunity to enhance the rate of return to the utility investor, while sheltering utility customers and assets from risk.

I would be happy to discuss this further and provide any additional information that you might need. Your interest and support for this legislation is most appreciated.

Sincerely,

Edw. A Wiegner

Edward A. Wiegner
Executive Vice President

EAW:ecd

cc: Mr. J. R. Underkofler

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Northern States Power Company

414 Nicollet Mall
Minneapolis, Minnesota 55401
Telephone (612) 330-6606

Arland D. Brusven
Secretary and Financial Counsel

December 15, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D C 20515

Dear Congressman Corcoran

This document is the response of Northern States Power Company, a Minnesota corporation, to your request for comments on the Public Utility Holding Company Act of 1935. The Company is an "exempt holding company" pursuant to order of the Securities and Exchange Commission. The Company's principal subsidiary is Northern States Power Company, a Wisconsin corporation, which provides electric and gas service in the western portion of the State of Wisconsin. (Under Wisconsin law, only domestic corporations may be engaged in the business of a public utility within the State of Wisconsin.) Under an agreement between the Company and Lake Superior District Power Company dated December 29, 1977, the Company proposes to affiliate with Lake Superior District Power Company, a Wisconsin corporation. An application to the Securities and Exchange Commission was filed in January, 1978, seeking an order for approval of the affiliation under the Public Utilities Holding Company Act and for a continuing exemption under the Act, except for Section 9(a)(2). The Securities and Exchange Commission has not yet issued an order on the Company's application. If an order of the SEC approving the transaction is received, the Company will have two public utility subsidiaries.

Proposal for amendment to the Public Utility Holding Company Act of 1935

Northern States Power Company does not propose the repeal of the Act. The goal of seeking reasonable latitude for our Company's operations does not require the total removal of limits on those activities and structures that were perceived to be abusive practices prior to the enactment of the Act. However, the law should be amended to permit rationalization of the corporate form consistent with interests of shareholders and consumers and to preclude the application of various criteria by the Securities and Exchange Commission which represent significant impediments to management actions which are not abusive to the interest of shareholders and customers.

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For the purposes of this discussion, "Approach Two" is proposed as the basis for amending the law; however, the amendment of the law should be expanded within the following criteria for an exemption upon order by the SEC:

1 Permit a "single layer" public utility holding company structure, irrespective of whether the holding company is "predominently a public utility company" and the number of public utility company subsidiaries provided all public utility subsidiaries operate within the state of incorporation of the holding company and in contiguous states. (Whether non-public utility subsidiaries extend the corporate structure to more than a single layer below the holding company or there are non-public utility activities outside the contiguous states should be irrelevant.)

2 Permit affiliation or merger between a "public utility holding company" and another public utility system provided that the acquired or merged publuc utility system meets the standards of an "integrated public utility system" under Section 11 of the Act and is within the state of incorporation of the holding company or contiguous states.

3 Permit affiliation or merger between or with a combination public utility without divestiture of the natural gas utility.

4 Permit the reorganization of an existing exempt holding company structure or existing public utility company within the above criteria.

5 Preempt state jurisdiction over the creation of separate corporate entities and the transfer of assets between affiliated entities to accomplish a corporate reorganization within the proposed criteria.

6 Require action by the SEC on any application under the Act within 18 months after filing of the application, with one extension not exceeding six months by order of the SEC if there is a reasonable question that the action for which the application is made is not consistent with the Act and there is reasonable cause for the delay. If the order is not issued within 18 months, or the extended date by order of the SEC, upon application by the applicant, the SEC shall issue its order within ten days approving the application.

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Supplemental discussion of proposal

The most significant result of "Approach Two" and the additional proposals is the removal of the "unless and except" clause and the requirement that an exempt holding company must be "predominently a public utility". As long as the law permits the SEC to apply criteria of the nature it has developed to the ratios between parent and subsidiary revenues, between electric and gas revenues, and between utility and non-utility in the grant of an exemption, in the continuation of an exemption, and upon review of an exemption, there is continuing jeopardy to any investment made by the affiliated group. Such ratios frustrate the creation of, and the continuation of, separate corporate entities for public utility operations based on state boundaries, for different utility operations, or other business activities.

A related problem associated with operation in various states is the disparate treatment by the state regulatory agencies on applications by a multi-state utility. The usual constraints on the transfer of assets to a separate corporate entity subject to state approval is a significant impediment to rationalizing the operation based on state jurisdictional boundaries. The difficulties incurred by public utilities arising from such multi-state jurisdiction can be modified by determinations by the Federal Energy Regulatory Commission on wholesale rates for electric and natural gas exchanged between separate "public utilities" which includes the separate affiliated entities.

Effect of enactment on state public utilities commissions, the utilities, stockholders, and ratepayers

With the federal regulatory scheme for rates by "public utilities" for electricity and natural gas sold at "wholesale", the ratepayers of each of the affiliated "public utilities" will be protected.

Since the "quality" of a public utility's earnings and its capital structure are a significant element in its capital costs, this would permit a mechanism to establish a fairer treatment of all ratepayers because it would restrict the ability of a single state to permit its ratepayers to "ride" on the quality provided by ratepayers in another state, the benefit of which inures to all ratepayers. Thus the ratepayers of a multi-state utility can be better protected from each other.

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The utilities will be able to rationalize the corporate structure consistent with regulatory requirements for public utility operations and to utilize financing techniques and capital structures for non-utility businesses consistent with business considerations which may be different from financing public utility operations. The stockholders have the potential to invest some of their "reasonable return" from the utility operations in other activities which could improve the attractiveness of the securities for the benefit or ratepayers as well as stockholders. The potential of the SEC to destroy the benefits of successful diversification or changes in the relationship of the various revenue areas of an affiliated group should be removed by amendment of the Act. In many instances, it is imperative that the law be changed before "non-utility" businesses can be realistically pursued by an exempt holding company or its affiliated companies.

Northern States Power Company has no present intention of becoming a "diversified company". It is expected that providing public utility services will be the dominent business of the affiliated group irrespective of corporate structure. However, the Company is evaluating alternatives in which it can diversify the use of its facilities and expand the employment of expertise used in its electric and natural gas operations and to better its utility operations. As the Act is currently constituted as interpreted by decisions of the SEC, it represents restrictions and potential jeopardy to the Company in even that limited a scope of broadening its business activities and change of corporate structure.

The foregoing comments are provided from the viewpoint of an "exempt public utility holding company" with integrated operations in four states, including a subsidiary in one state and seeking SEC approval for the acquisition of another public utility. It is our reaction that specific difficulties presented by the Act for our operations can be remedied by amendment of the Act as proposed in "Approach Two" with some embellishments.

Very truly yours

ARLAND D. BRUSVEN
Secretary and
Financial Counsel

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Washington Gas

DONALD J. HEIM
PRESIDENT

December 23, 1981

Representative Tom Corcoran
Longworth House Office Building
Room 1107
Washington, D.C.

Dear Congressman Corcoran:

First, we would like to express our appreciation to you for the opportunity to express our opinions on the questions posed by you in the attachment to your letter of October 27, 1981. You are exploring matters which are of great concern to this company and which are also matters of great national concern.

Any regulatory scheme that impedes the most efficient utilization of the economic and financial resources of this country must be eliminated. In our opinion, the Public Utility Holding Company Act (which we will refer to throughout our response as the "1935 Act") constitutes a formidable obstacle to the maximum utilitization of the resources and the management talent of companies in the energy industry. It is imperative that its role, its functioning, its utility and its continued viability be critically and carefully examined and we are pleased that you have undertaken such an examination.

First, Washington Gas Light is exempt from the 1935 Act by virtue of Section 3(a)(2) since, while Washington Gas Light is a holding company in the technical sense, it is primarily an operating company whose distribution operations are confined to contiguous areas; namely, the District of Columbia, Maryland and Virginia. We have two small gas distribution subsidiaries and several non-utility subsidiaries, including one which is actively engaged in exploration for, and the production of, gas in Oklahoma.

As a consequence of the exemption which Washington Gas Light enjoys, it is not subject to the strictures of the 1935 Act. However, its exemption is subject to elimination or restriction at any time if the Securities and Exchange Commission finds that the basis for the exemption no longer exists. A simple example will demonstrate the problem. Like most corporations we are continuously reviewing the structure of our corporation and the means by which changes might be made in it to maximize our efficiency and our ability to use the resources available to us. Among

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the several options which we have from time to time considered is the option of restructuring ourselves by creating a holding company which would own all the stock of the present Washington Gas Light and which would also hold directly, rather than through Washington Gas Light, the stock of the present Washington Gas Light subsidiaries. If this were done, our exemption would be lost and we would become subject to the full scope of regulation under the 1935 Act. Similarly, if we were to engage in a diversification program less closely related to the production and distribution of gas than our present program, there is a strong possibility that the Commission would, as it did several years ago in the case of Pacific Lighting Corporation, seek a revocation of the exemption.

Thus, while Washington Gas Light is exempt from the 1935 Act, it is severely inhibited in restructuring itself in the manner which management might believe offers the greatest opportunity for the utilization of its resources and in extending its activities in ways that would benefit its shareholders.

We believe that our comments can be most helpful to you if we respond to approaches one and two jointly rather than discretely; so that is how we shall respond.

First, we believe that the most favorable approach, at least insofar as gas distribution companies are concerned, would be the repeal of the 1935 Act, or at least the grant of an exemption from it to gas holding companies. If for any reason such a broader approach is not practicable or desirable, then we believe the second approach suggested by you, the grant of an exemption to holding companies having only one public utility subsidiary whose operations are limited to the state of incorporation and contiguous states and to holding companies created by companies presently exempt under Section 3(a)(2) of the 1933 Act and the elimination of the "unless and except" clause in the 1935 Act, would be desirable.

In responding to the specific questions posed under your approaches, it is essential the events and practices which led to the 1935 Act be reviewed and that changes in the industry, the economy, financial practices, securities regulation and accounting and auditing procedures be recognized.

Prior to 1935 there had developed in this country vast, sprawling utility complexes. These had grown with little or no concern for the interests of consumers or investors. They were characterized by hit-and-miss acquisitions all over the country; extremely unsound financial practices often involving excessive debt and control exercised by relatively small holdings of common stock; improvident contracts between the holding companies and their service subsidiaries and the operating subsidiaries; the bleeding off of profits from the operating companies; and a host of other abuses. These were documented in an eight-year study done by the Federal Trade Commission in the late '20s and early '30s, the findings of which study formed the foundation for the 1935 Act.

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Prior to 1935 the quality and quantity of regulation of utility activities by the states was for the most part weak and ineffective. Moreover, Supreme Court decisions had severely limited the ability of the states to secure information with regard to holding companies and their diverse activities and to control the financial practices of the holding companies and contracts between them and their subsidiaries. Moreover, the continuous reporting requirements of the Securities Exchange Act of 1934 were new and their effect unknown. Moreover, only companies listed on registered securities exchanges were subject to those disclosure requirements. The financial industry had, prior to 1935, too often been "accomplices" in effectuating the unsound financings of the holding company complexes. The accounting profession had not developed sophisticated accounting and auditing practices such as we have today.

In that environment, it may fairly be said that the 1935 Act was a salutary and wise piece of legislation (although, ironically, given the vast and recognized extent of the abuses, it carried in the Senate by a single vote margin).

The heart of the 1935 Act was Section 11, which gave the Securities and Exchange Commission the power to restructure public utility holding companies into financially and geographically integrated and coherent structures. It may fairly be said that virtually everything else in the Act was ancillary to Section 11 and that the other provisions were largely intended to forestall the recurrence of past abuses and provide assurances of continued integrity.

By the mid-1950's the Securities and Exchange Commission in what can only be described as a superb achievement had virtually completed the job of restructuring the holding companies in accordance with the standards of Section 11. A number of the holding companies had reorganized themselves in a fashion that won them an exemption from the Act; the others, those which were required to register under the Act, were geographically and financially sound.

Since 1935 the activity of the Securities and Exchange Commission in administering the 1935 Act has been largely confined to the approval of financings, the review of applications for exemption, administration of the disclosure requirements, reviewing acquisitions proposed by registered companies and similar activities.

Vast changes have occurred in the utility and financial world. Under the Securities Exchange Act of 1934, the Securities and Exchange Commission has erected a formidable system of disclosure that applies, not only to all listed companies, but to any company with more than $1 million in assets and 500 shareholders; all registered holding companies, and virtually all other utilities of any significant size, are subject to the disclosure requirements of the 1934 Act. Moreover, as a result of increasing sophistication among analysts, utility companies have been increasingly pressed by market forces to maintain their financial integrity lest their ability to finance replacement and expansion of facilities be severely hampered. Thus, any utility proposing an unsound financing would

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find it extremely difficult to secure the assistance of a responsible underwriter, its rating would be impaired, the marketability of its securities would be hampered, and it would pay exhorbitant interest for its borrowings, a circumstance which would undoubtedly subject it to significant scrutiny and perhaps adverse ratemaking action by state authorities.

Moreover, many of the constitutional restrictions on the activities of state public utility commissions perceived by the Supreme Court prior to 1935 are no longer seen today. Thus, it is accepted that state commissions have extensive powers to regulate, in most instances, contracts between distribution companies and their parents and service subsidiaries of the parents. Furthermore, the sophistication, the skills and the aggressiveness of state authorities have increased immensely since 1935; in addition, legislatures have accorded to such authorities significantly greater power than they once had. Thus, through their ratemaking power, state commissions can control and inhibit many of the activities which existed before the 1935 Act.

The accounting profession has refined greatly accounting and auditing standards and the sense of responsibility in the accounting profession to exercise independent judgment with regard to the financial statements audited by its members has vastly increased. It would be impossible today for a public utility holding company to engage in the financial and accounting practices of the pre-1935 period and secure a favorable opinion from its auditors.

Thus, for a host of reasons, it is virtually inconceivable that the abuses which predated 1935 would arise again. State regulatory authority, market forces, heightened sense of responsibility on the part of financial institutions and auditors, realization that such abuses would quickly lead to liability and disciplinary action, all these combine to assure that the abuses intended to be remedied by the 1935 Act would not recur.

In the foregoing are implicit the answers to the specific questions which you have asked under approaches one and two.

With respect to question 1 under approach one, at the present time utility companies do not present the problems of size and complexity the 1935 Act was intended to correct. As indicated above, by the 1950s the complexities that attended holding companies prior to the 1935 Act had been successfully eliminated by a combination of voluntary action by the holding companies and regulatory mandate by the SEC. Of course, many of the utility holding companies as well as many of the utility companies not parts of holding company complexes are large corporations by any standards. However, there is no evidence that their size poses any regulatory or economic problems; rather, in most instances, such size results in economies of scale, better service to consumers, and more attractive opportunities for investors.

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With respect to the second question under approach one, we believe that, were the 1935 Act repealed, remaining federal and state laws would adequately protect the interests of stockholders and ratepayers. First, with regard to ratepayers, the repeal of the 1935 Act would in no way diminish the regulatory authority of the Federal Energy Regulatory Commission which would continue to have jurisdiction over the wholesale price of gas, and the present restrictions with regard to the price of gas at the wellhead would continue pursuant to the program for decontrol incorporated in the Natural Gas Policy Act. Similarly, the powers of the state commissions would continue unabated and they would continue to have jurisdiction to establish rates and perform a number of functions collateral to that, including, in many instances, review of the propriety and fairness of contracts with affiliates of distribution companies. Consumers are obviously concerned with the continuity and reliability of service and the rates they pay for energy. These are the primary concerns of the state regulatory authorities and there is no reason to believe that the effectiveness of that regulation would be impeded were the 1935 Act repealed.

Investors in publicly held companies in general are protected under the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. It has been the prevailing philosophy of federal securities regulation that investors be given all material information and that, possessing that, they have the unimpeded right to make their own judgments with regard to specific investments. The federal securities laws in general clearly repudiate the "paternalistic" notion that in some fashion the federal government should intrude itself in the investment process beyond assuring that all material information is available to investors. This system has worked effectively for the overwhelming bulk of American industry. There is no reason to believe that investors in public utility holding companies need or should have an additional measure of protection such as that purportedly now afforded by the 1935 Act. Moreover, the investors are further protected by considerations discussed above, namely, the enhanced integrity of the financial community, the independence of the accounting profession, the development of sophisticated accounting and auditing standards, the high quality of financial analysis and a number of other factors. Because of the weaknesses that existed before 1935 in accounting standards as well as financial practices in underwritings and the absence of an extensive and well trained analyst community, it may have been desirable to afford investors in public utility holding companies the additional protections given by the 1935 Act, but such is no longer the case.

In answer to question 3 under approach one, it is difficult to imagine that the repeal of the 1935 Act would result in any greater conflict in state regulation than presently exists. Washington Gas Light is subject to the regulatory authority of the District of Columbia and the states of Maryland and Virginia, but it is not subject to the regulatory authority of the SEC under the 1935 Act. Our experience is that, while occasionally there may be problems with respect to the allocation of assets among operations in the three jurisdictions in connection with ratemaking proceedings, those problems have generally been satisfactorily resolved in a manner that is consistent with the interests of consumers and investors.

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There is little reason to think that if Washington Gas Light were subject to the Public Utility Holding Company Act there would be any abatement of these problems.

With respect to question 4 under approach one, it is doubtful whether members of the public have any awareness that the holding companies which own the operating companies with which they are familiar and with which they deal are subject to a separate scheme of federal regulation. They are generally only aware that they purchase their gas or electricity from the local utility and they perceive that the activities of those utilities are regulated by state authority. We suspect that any sort of opinion survey would disclose almost total ignorance by the public of the existence of the Public Utility Holding Company Act and its operations and provisions. Thus, it is extremely unlikely that the repeal of the Act would have any effect upon the confidence of the public.

The answer to question 5 under approach one we believe is fairly indicated above. The powers of the state public utility commission would, as indicated, continue unabated. It is conceivable that in some instances where the statutory basis of regulation in a state was perceived to be inadequate the repeal of the Act might lead to legislation strengthening the powers of the state authorities. Inasmuch as there are among the states a variety of statutory provisions, it may well be that the repeal of the Act would lead to a greater uniformity among state statutes, with weaker statutes being supplemented or replaced by stronger provisions. The stockholders of public utility holding companies would be placed in the same position as the stockholders of other publicly held corporations: they would, as they do now in making other investments, rely upon disclosure in making their decisions; the financial reports furnished to them would continue to be prepared in accordance with generally accepted accounting principles adopted by the accounting profession under the oversight of the Securities and Exchange Commission; such statements would be accompanied by reports of independent auditors subject to statutory and professional requirements to insure integrity. In short, they would have the same protections as investors in other companies. Ratepayers today are principally protected by the state regulators who set the rates and it is doubtful whether the effectiveness of this rate setting would be adversely affected by repeal of the 1935 Act, particularly in states which gave their regulators statutory authority over contracts with affiliates and authority to secure information with regard to the activities of holding companies.

With regard to the utilities themselves, for the most part the operating companies would operate in the same fashion in which they presently do. Each of them is subject to the state authority and must satisfy those authorities with regard to their requests for modifications of rates. Similarly, they are subject to a number of penalties if they fail to provide adequate service. It is probable that their mode of operation would continue exactly as it is presently.

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With regard to diversification, it is likely that repeal of the 1935 Act would result in greater diversification on the part of holding companies presently registered and on the part of companies which are exempt, but which have foregone opportunities for diversification because of concern over the loss of their exemption. Diversification is an extraordinarily complex subject. However, there is no reason to believe that, given the opportunity, utility holding companies would diversify in ways that are inimical to the public interest or the interests of consumers or the interests of investors. State authorities, with their extensive ratemaking powers, would be able to determine whether diversification is inappropriately bleeding resources away from the operating companies, and if so the shareholders of the holding company could be penalized through ratemaking.

The inability of public utility holding companies to diversify their activities exacts many penalties. Statistical evidence suggests that the cost of financing for holding companies exceeds in many instances the cost for other similarly situated companies which are not subject to the constraints of the 1935 Act. Similarly, it is more difficult for such companies to recruit aggressive, dynamic management because they afford only limited opportunities for imaginitive use of resources. Moreover, many businesses engaged in activities similar to those engaged in by holding companies can and have diversified successfully -- for instance, utilities that are totally intrastate, interstate pipeline companies and the like.

The limited experience of Washington Gas Light with permissible diversification is an example of the benefits that can flow to investors and to consumers. The company has been engaged in gas exploration and production activities in Oklahoma. This has had a favorable effect upon the price of the stock of the company, and may reasonably be expected to have a favorable effect upon the Washington Gas Light's ability to engage in equity or debt financing. To the extent that these results follow, the cost of providing service to consumers of gas will be reduced. This will be reflected in their rates, and at the same time investors will receive a better total return on their stock.

We trust that these views will be of assistance to you in appraising the benefits which would flow from (a) a total repeal of the 1935 Act, (b) an exemption of gas utility holding companies from it, or (c) a more limited exemption as outlined in your proposal two.

If we can be of further assistance to you in analyzing these problems, we hope you will feel free to call upon us.

Yours very truly,

D J Heim

Donald J. Heim
President

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Wisconsin Power & Light Company
Investor-owned Energy
222 West Washington Avenue . P O Box 192 Madison, Wisconsin 53701 Phone 608/252 3311

EXECUTIVE OFFICES

December 31, 1981

The Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Reference: H. R. 5220
Your Letter December 23, 1981

Dear Congressman Corcoran:

I believe our letter of December 9, 1981 was responsive. However, if we have missed something, please let me know.

We sincerely appreciate your interest and attention to this very important matter.

Best regards.

Sincerely yours,

James R. Underkofler
President

JRU:bkr

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Al-Udall's Assistant

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Bay State Gas Company
Corporate Offices
120 Royall Street
Canton, Massachusetts 02021
Area code - 617-828-8650

December 30, 1981

Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, DC 20515

Dear Congressman Corcoran:

Your letter to our Chief Executive Officer, Charles Tenney II, has been forwarded to me. I have read your proposed "Public Utility Financial Reform Act" with great interest. The corporate diversification, it would permit, is essential to provide the corporate financial strength necessary in the energy industry today. Such financial strength benefits both customers and shareholders alike. If the energy industry is expected to provide services in the most efficient and cost effective manner, it must be permitted the corporate flexibility that makes the free enterprise system work.

I have discussed the provisions of S.1869, S.1870 and S.1871 with Senator Paul Tsongas and will speak with him further about HR 5220. As I meet with the several U.S. Representatives in Massachusetts from time to time, I plan to indicate our keen interest in the passage of your legislation.

Very truly yours,

BAY STATE GAS COMPANY

John D. Sampson
Vice President

5 1982

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DAN'S NOTES:

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KANSAS CITY POWER & LIGHT COMPANY
1330 BALTIMORE AVENUE
P.O BOX 679
KANSAS CITY, MISSOURI 64141

January 5, 1982

ARTHUR J. DOYLE
CHAIRMAN OF THE BOARD
AND
PRESIDENT

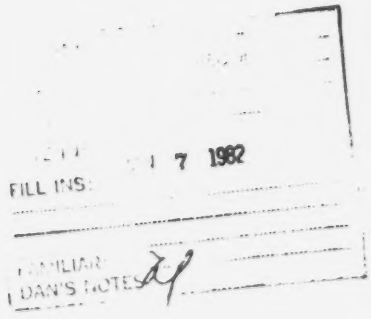
The Honorable Tom Corcoran
Congress of the United States
House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Corcoran:

We appreciate your efforts in seeking amendments to the Public Utility Holding Company Act and support the approach you have taken in H. R. 5220.

Sincerely,

AJD:be



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TECO ENERGY, INC.
P. O. Box 111
TAMPA, FLORIDA 33601

H. L. CULBREATH
PRESIDENT

January 6, 1982

The Honorable Tom Corcoran
Representative in Congress
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Corcoran:

I am responding to your request for comments on the proposed legislation amending the Public Utility Holding Company Act of 1935.

We are supportive of H.R. 5220 which you introduced in December. The electric and gas utility industries should be permitted to develop prudent programs of diversification into non-utility activities within the parameters of state regulation.

Such diversification would be more appropriate in a holding company structure so as to distinguish clearly between utility and non-utility operations. The electric and gas industries should have the opportunity to pursue the normal business practice of diversification; the '35 Act makes that impossible for some companies, very difficult for others.

The "unless and except" clause (section 3, paragraph[a]) in the Act can be a major deterrent to the use of the holding company structure and therefore to diversification; it should be removed, as provided for in your bill.

We believe that carefully managed non-utility businesses through time may well improve the financial performance of the electric and gas industries. Any improvement in the financial characteristics of our industries would clearly benefit both our customers and our investors.

If I can be of assistance to you in any aspect of this work, please let me know.

Sincerely,

H. L. Culbreath

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MISSISSIPPI POWER & LIGHT COMPANY
Helping Build Mississippi
P. O. BOX 1640, JACKSON, MISSISSIPPI 39205

DONALD C. LUTKEN
PRESIDENT

January 5, 1982

Honorable Tom Corcoran
United States Representative
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Corcoran

Your interest in the adverse effects of the Public Utility Holding Company Act is deeply appreciated.

In response to your letter of December 23, 1981, I feel very strongly that the Act has adequately served its original purpose and now has no useful function.

Subsequent to the adoption of the Act nearly fifty years ago, the Congress has adopted other safeguards that protect the public from any recurrence of the events which led to passage of the Act.

I hope you can sponsor legislation which repeals this cumbersome, restructive and obsolete statute.

Sincerely

DCL:sb

cc - Mississippi Congressional Delegation
System Chief Executive Officers
System Public Affairs Committee

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SOUTH CAROLINA ELECTRIC & GAS COMPANY
POST OFFICE BOX 764
COLUMBIA, SOUTH CAROLINA 29218

V. C. SUMMER
PRESIDENT
CHIEF EXECUTIVE OFFICER

January 12, 1982.

The Honorable Tom Corcoran
Representative in Congress
1107 Longworth House Office Building
Washington, DC 20515

Dear Congressman Corcoran:

Thank you for your letter of December 23, 1981, enclosing information relative to H.R. 5220, the "Public Utility Financial Reform Act," a bill which you introduced on December 15, 1981.

Our Company has been following the proposals to amend the Public Utility Holding Company Act of 1935 to facilitate diversification by electric and gas utilities into nonutility businesses. We believe that H.R. 5220 would be highly beneficial to the utility industry and could lead to a means of improving the industry's financial performance and stability and thus contribute to the well-being of the Nation's energy resources.

We are asking all members of our South Carolina Delegation to support this bill as being in the best interest of the electric and gas industry and their customers.

Very truly yours,

Virgil C. Summer

lhf

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Northern Indiana Public Service Company
General Offices / 5265 Hohman Avenue / Hammond, Indiana 46325 / Tel.: 853-5200 (219)

I. J. ROBERTS
VICE PRESIDENT

January 18, 1982

The Honorable Tom Corcoran
United States House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 5220, Public Utility Financial Reform Act

Dear Congressman Corcoran:

Responsive to your letter of December 23, 1981, to Mr. Edmund A. Schroer, the Company is pleased that you introduced H.R. 5220. As a member of the group of electric and gas utility companies that have been working to amend the Public Utility Holding Company Act of 1935, we believe that the Reform Act you are proposing would lower significant barriers to utility diversification. It is our thought that diversification is one avenue toward promoting increased financial strength for the utility industry.

As you know, the Securities and Exchange Commission on December 21, 1981, wrote to Senator D'Amato urging repeal of the entire 1935 Act. In light of the Commission's judgment that the regulatory burden created by the 1935 Act is no longer warranted, we urge you and your colleagues to give serious consideration to repeal. We think Congressional hearings on the 1935 Act will demonstrate that vast changes in the utility industry and regulation since passage of the 1935 Act have combined to make its particular form of regulation unnecessary.

The Company thanks you for your leadership and consideration of the issue, and stands ready to help in whatever way it can.

Very truly yours,

IJR:mah

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DAN'S NOTES:

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PUBLIC
SERVICE
INDIANA

Hugh A. Barker
Chairman and
Chief Executive Officer

January 12, 1982

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D. C. 20515

Dear Representative Corcoran:

Thank you for your letter of December 23, 1981 enclosing a copy of H.R. 5220 and a list of the respondents to your October 27 letter. We have reviewed the proposed bill and endorse it as constructive legislation. This type of thoughtful deregulation is a step in the right direction.

Sincerely,

Hugh A. Barker

HAB:gm

DATE ANS: DOC #:
REC #:
1982
FAVORABLE
DAN'S NOTES

1000 East Main Street, Plainfield, Indiana 46168 317 .. 838 . 1242

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CPnational
BEN W. AGEE
PRESIDENT AND
CHAIRMAN OF THE BOARD

January 25, 1982

The Honorable Tom Corcoran
United States Congressman
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Corcoran:

Thank you for your letter of December 23 inviting CP National's comments on proposed amendments to the Public Utility Holding Company Act that would be achieved through your introduction of H.R. 5220. You also solicted other approaches including total repeal.

We are very appreciative of your concern for the financial health of our nation's public utility companies and for your introduction of legislation permitting public utility diversification that would provide an apportunity for utilities to bring earnings to a reasonable level. We at CP National have begun to develop our own diversification program.

We favor total repeal of the Act. However, we believe that any amendments to the Holding Company Act that would relieve restrictions relating to diversification would be of considerable assistance.

Sincerely,

Ben W. Agee
President and Chairman

BWA:jlw

cc: Edison Electric Institute
National Association of
Regulatory Utility Commissioners

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1355 WILLOW WAY, CONCORD, CA 94520, P.O. BOX 4032, CONCORD, CA 94524 (415) 680-7700

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THE STATE OF WYOMING

ED HERSCHLER
GOVERNOR

Public Service Commission

CAPITOL HILL BUILDING
320 W. 25TH STREET CHEYENNE, WYOMING 82002

JOHN R. SMYTH
CHAIRMAN
G. KEITH OSBORN
DEPUTY CHAIRMAN
C.E. "NED" JOHNSON
COMMISSIONER
ALEX J. ELIOPULOS
CHIEF COUNSEL AND
ADMINISTRATIVE SECRETARY

FRANK L. RAUCHFUSS
DIRECTOR, UTILITIES DEPARTMENT
DELBERT L. BOYER
CHIEF ENGINEER
WILLIAM M. ROONEY
DIRECTOR MOTOR TRANSPORTATION
WILLIAM L. JOHNSON
DIRECTOR RATE AND TARIFF

November 9, 1981

Tom Corcoran
Representative in Congress
House of Representatives
Washington, D.C. 20515

Re: Proposed legislative action on Public Utility Holding Company Act of 1935

Dear Mr. Corcoran:

We sincerely appreciate your permitting us to reply to two legislative approaches to amending the Public Utility Holding Act of 1935 in an effort to relieve the financial plight of the utility industry. This Commission has not been faced with the holding company problem since only one very small gas utility (Cody Gas Company) would be affected; therefore, we do not feel it appropriate to venture unsupported opinions.

We appreciate your keeping us advised on this important matter.

Yours very truly,

JOHN R. SMYTH, Chairman

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GEORGE R. ARIYOSHI
GOVERNOR

STATE OF HAWAII
PUBLIC UTILITIES COMMISSION
DEPARTMENT OF BUDGET AND FINANCE
1164 Bishop Street, Suite 911
Honolulu, Hawaii 96813

JENSEN HEE
DIRECTOR OF BUDGET & FINANCE

ALBERT Q.Y. TOM
Chairman

Clyde S. DuPont
Commissioner

SUNAO KIDO
Commissioner

November 13, 1981

The Honorable Tom Corcoran
Representative, 15th District
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Representative Corcoran:

The Commission received your letter of October 27, 1981 with enclosure of proposals concerning amendments to the Public Utility Holding Company Act of 1935.

The regulatory commissions throughout the country are being confronted with diversification requests by the regulated utility companies under their jurisdictions. While the plight of the utility industry to seek alternatives is recognized by most regulatory commissions, the major concern of the commissions have been the exposure of utility assets and operations to insure adequate and reliable utility service to the public.

While each state regulatory commission will continue to exercise its regulatory responsibilities as to the regulated utility within its jurisdiction. a uniform compact agreement between the states may be necessary to assure state by state cooperation in non-regulated activities that may impact on the regulated portion. Similarly, a compact agreement between all states will facilitate the affected holding company's reporting requirements with respect to the regulated operations of the company in the states in which they operate.

In essence, we favor the features in your proposed Option Plan II with possible modifications while retaining the general concept of the Public Utility Holding Company Act which will also provide the Securities and Exchange Commission an opportunity to review any weak ares that the respective state statutes' may have at the present time or in the foreseeable future. As a member of NARUC, we also support the position of the organization on the subject matter.

We hope the foregoing comments will assist you in the review of the Public Utility Holding Company Act of 1935 and your concurrent concerns on the financial plight of the utility industry. We share the same concerns on the well-being of the utilities, while equally being concerned of the interest of the utility ratepayer.

Very Truly Yours,

Albert Tom

Albert Tom, Chairman

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STATE OF COLORADO

THE PUBLIC UTILITIES COMMISSION
Department of Regulatory Agencies

500 State Services Building
1525 Sherman Street
Denver, Colorado 80203

November 10, 1981

Richard D. Lamm,
Governor

Wellington E. Webb
Executive Director

COMMISSIONERS
Edythe S. Miller
Chairwoman

Daniel E. Muse
L. Duane Woodard

Harry A. Galligan Jr.
Executive Secretary

Administration (303) 866-31
Transportation (303) 866-31
Fixed Utilities (303) 866-318
Counsel (303) 866-3188

The Honorable Tom Corcoran
United States Representative
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

I am in receipt of your letter of October 27, 1981, concerning possible amendments or repeal of the Public Utility Holding Company Act of 1935. Due to time constraints, we will not be able to respond to your letter by November 25, 1981. However, it may be possible for us to provide you with our views at a later date, assuming sufficient time is allowed, with respect to the two approaches outlined in the discussion paper attached to your letter. If this will be helpful, please let us know, and also the outside date by which a response would meet your needs.

Very truly yours,

Edythe S. Miller

EDYTHE S. MILLER
Chairwoman

ESM/vjr

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IDAHO PUBLIC UTILITIES COMMISSION

STATEHOUSE
BOISE, IDAHO 83720
334-3143

PERRY SWISHER
President

JOHN V. EVANS
Governor

November 11, 1981

The Honorable Tom Corcoran
U. S. Representative
1107 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Mr. Corcoran:

Your name evokes memories of Tommy the Cork. A very different breed of Irishman.

Enclosed is an excerpt from an analysis by Leonard Human of Merrill Lynch. He's the best establishment analyst of electric utilities, in my experience.

Distributing elecrticity is a natural, cost-effective monopoly. Producing energy, including electricity, is not. So I urge conservatives like you to help market-place principles work in supplying energy. Encourage utility executives to wean themselves from a fixation on central plant in this era when once again energy is where you find it.

We need mix, diversity, competition, the innovativeness of the private sector. Let entrepreneurs harness resources that are now wasted, undeveloped, or denied the subsidies that flow to the old suppliers.

I agree with you that the Holding Company Act is obsolete in several important respects. You should be working for changes. But you live in the land of Samuel Insull (as well as Lincoln) while I live where many of us did without in the Insull-Ebasco era--despite our magnificant hydro resource. The key is not in restoring the iron-tight trusts of the 1920's but in going back still farther: To pre-World War I when industry, not utilities, originated more than half of the electricity generated and every community contained a mix of energy from resources close at hand.

As long as Republicans are in the saddle, ride all the way back to Theodore Roosevelt. The Calvin Coolidge approach won't work. It never did. When national leadership turns bland, things climb in the saddle "and ride mankind."

Very truly yours,

Perry Swisher
President

PS:kl

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price of central station power to them is below its real economic value. Who gains from the perpetuation of the natural monopoly concept beyond its useful life? Clearly the big user of power. Who loses? The utility company. What about the economy as a whole? Just a clearly, the present system leads to misallocation of resources and excessive use of electric energy.

3) The principle that electricity is a religion rather than a commodity - Many regulators and industry executives take the view that central station electricity is different from other services and commodities. They point out that the economy will stop without it, that electricity will play a big role in reducing our dependence on oil, that automation won't take place without it, and on and on. Now let's take this argument to its logical conclusions, conclusions that were drawn by public power advocates in the 1920s and 1930s, incidentally. Not only must price be controlled so that all can afford their fair share, but quality of service must remain at extraordinarily high levels because nobody can afford to be without power. Furthermore, we must not tinker with the present system if doing so will have any impact on availability or price of power. Now for the clincher: maybe electricity is too important to be left in the hands of private enterprise. As far as I am concerned, this view of electricity as a religion is one of the greatest threats to the viability of the industry. I don't see why society should make the value judgment that electricity should be furnished to the consumer at a price below economic costs, with the subsidy coming from investors, as opposed to the furnishing of other services or commodities by private companies. Generally, it is left to government-owned entities to provide services below cost for social reasons. My point is that many users of electricity would accept a different standard of service if price were adjusted to make such acceptance worthwhile. Moreover, if the price of central station power were realistic, many users might find it advantageous to provide their own power. In other words, with proper pricing, users would see central station power more as a commodity that could be replaced by other commodities. Suppliers would make decisions on an economic basis, rather than acting as missionaries offering salvation to the pagans. The invisible hand would be unchained, and we could see an end to the mismatch between supply and demand.

These principles apply to both diversification and deregulation. Let's first attack diversification, which most of you will acknowledge as a possibility. What are the motives to diversify?

Motive # 1: Promote a higher stock price by convincing investors that the utility will metamorphose into an exciting company sometime in the future. That way you get a better stock price and can throw money with abandon into your utility operation. Sad to say, investors aren't fooled that easily. They won't pay for intentions.

Motive #2: Build an empire. No comment required.

Motive # 3: Reduce the risk inherent in a one-line business. Try not to pick a second line riskier than the first, though.

Motive #4: Protect market share, after market is defined as the end use. Seek to serve that end use for energy in the most profitable and economical fashion, rather than only through central station power.

Motive #5: Make profitable use of assets and expertise already within the corporation in an unregulated environment.

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State of Wisconsin \ PUBLIC SERVICE COMMISSION

STANLEY YORK, CHAIRMAN
WILLIE J. NUNNERY, COMMISSIONER
BRANKO TERZIC, COMMISSIONER
4802 SHEBOYGAN AVENUE
P.O. BOX 7854
MADISON, WISCONSIN 53707
(608) 266-1241

November 13, 1981

File No.

The Honorable Tom Corcoran
U.S. House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

Thank you for your letter of October 27, 1981, concerning possible changes in the Public Utility Holding Company Act of 1935. At the present time, one Wisconsin gas utility is subject to PUCHA, and two Wisconsin combination gas and electric utilities have applied to the Securities and Exchange Commission to form holding companies. This commission is therefore concerned about holding company issues both within Wisconsin and nationally.

Our chief economist, J. Robert Malko, and his staff have prepared a report on the issues involved with the regulation of energy utility diversification and utility holding companies. I have enclosed a copy of this report, which has been circulated nationally among regulators, utilities and public counsels. Your discussion outline/questions on PUCHA have been referred to Dr. Malko's office. For this commission's concerns specific to Wisconsin, please read the enclosed letter to the SEC dated October 9, 1981.

I have been appointed Chairman of the recently established Ad Hoc Committee on Utility Diversification of the National Association of Regulatory Utility Commissioners. A copy of drafts for the report study plan outline are enclosed. The committee will meet in San Francisco on November 19. The committee's report will discuss the matter of federal regulation of utility holding companies. We will, therefore, keep you informed on this aspect of our work.

Sincerely,

Stanley York

Stanley York
Chairman

SY/GE/dm

Enclosures

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PUBLIC UTILITY COMMISSIONER OF OREGON

LABOR & INDUSTRIES BUILDING, SALEM OREGON 97310 PHONE (503) 378-6611

November 19, 1981

The Honorable Tom Corcoran
US House of Representatives
Washington DC 20515

Oregon is a smaller state in terms of the number and size of the utilities its regulates. As such, we have had only minor problems to date concerning the Public Utility Holding Company Act of 1935, nor have any of the utilities in the state expressed to us significant concerns in this area.

I can say that with regards to Question 4 of your "Approach One" that there appears to be public confidence in the regulatory process in our state. Although there is little federal regulation of local utilities in Oregon, we have found that such regulation is sometimes slow in responding and inferior to state regulation if only because of its remoteness from the jurisdiction involved. We would, therefore, expect to see that all interests--consumers and investors--are protected in our regulatory process regardless of any changes in the Act.

I would certainly favor repeal.

John E. Jobdell
Commissioner

wr/1727W

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COMMISSIONERS

THOMAS J. HATEM
CHAIRMAN
WILLIAM A. BADGER
JACK R. SCHIFTER
WAYNE B. HAMILTON
HASKELL N. ARNOLD

STATE OF MARYLAND

JAMES A. PINE
GENERAL COUNSEL

RONALD E. HAWKINS
EXECUTIVE SECRETARY

GLORIA M. JIMENEZ
EXECUTIVE DIRECTOR

PUBLIC SERVICE COMMISSION

AMERICAN BUILDING
231 E. BALTIMORE STREET
BALTIMORE, MARYLAND 21202
(301) 659-6000

TTY FOR DEAF BALTO. AREA 383-7555
D.C. METRO 565-0451

November 24, 1981

The Honorable Thomas Corcoran
Representative in Congress
House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

This is in response to your letter of October 21, 1981 to Chairman Hatem with regard to the amendment or repeal of the Public Utility Holding Company Act of 1935. This is an issue which we have not completely researched so at this point I can only provide you with the staff's first impressions of the possibility of repeal or amendment.

While the utilities regulated by this Commission might disagree, it would appear that PUHCA has not inhibited the diversification moves of a number of them. As long as the rate payers are not prejudiced by these activities and funds are not siphoned from the regulated business to the unregulated activities, regulatory bodies should not be concerned. Our experience with the telephone industry, however, indicates that there are great difficulties in keeping these activities separate. The staff of this Commission would recommend that we approach any change in the status quo with caution.

I regret that we cannot be of more assistance at this time. When we have done some further research in this area, we will most certainly share our thoughts with you.

Sincerely,

Gloria M. Jimenez
Executive Director

GMJ:adr

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COMMONWEALTH OF VIRGINIA

THOMAS P. HARWOOD JR.
CHAIRMAN
LEWIS L. BRADSHAW
COMMISSIONER
PRESTON C. SHANNON
COMMISSIONER

WILLIAM C. YOUNG
CLERK OF THE COMMISSION
BOX 1197
RICHMOND, VIRGINIA 23209

STATE CORPORATION COMMISSION

November 23, 1981

The Honorable Tom Corcoran
1107 Longworth House Office Building
Washington, D. C. 20515

The Honorable Tom Corcoran:

I have read with interest your letter and discussion paper concerning the Public Utility Holding Company Act of 1935. Your efforts to understand the perspective of public utility commissions concerning a possible repeal or amendment to PUHCA is appreciated.

It would appear that PUHCA is an outdated piece of legislation that should either be repealed or restructured. The problems that existed in the corporate structures of certain utility holding companies 46 years ago are no longer present. Many of the utility holding companies of that time apparantly were based on a pyramid type structure that would possibly collapse in times of economic difficulty. The same is not true today.

Today's utility industry is faced with a multitude of problems. The PUHCA represents a layer of regulation upon the companies it controls that is often redundant. For instance, most companies regulated by the Act must get prior approval for financing from both the SEC and a state regulatory agency. Delays in approval of financing methods can be critical in today's unsettled financial markets. We must allow utilities to function with flexibility in this area. This flexibility will, in the long run, benefit both the stockholder and ratepayer.

If the PUHCA were repealed, the interests of the stockholder and ratepayer in Virginia would continue to be protected by our Commission. We already monitor changes in the structures of the utilities we regulate. For instance, a common procedure in our rate case audits is to study the changes in the structure of charges a parent company passes on to its subsidiary.

It is impossible to predict how repeal of the PUHCA would affect the diversification efforts of the companies involved. It must be remembered, however, that only a small percentage of the companies we regulate are controlled by the PUHCA. Diversification is an issue we must face whether the Act is repealed or not.

I feel the public in the Commonwealth of Virginia does have enough confidence in our Commission so that the federal role in regulation can be reduced. I have no doubt that we will be able to provide adequate regulatory oversight in the event of repeal or amendment to the Public Utility Holding Company Act of 1935.

Sincerely,

Preston C. Shannon
Commissioner

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State of Kansas

JOHN CARLIN, Governor
RICHARD C. PETE LOUX, Chairman
ANNE T. ROY, Commissioner
PHILIP R. TICE, Commissioner
CAROL J. LARSON, Executive Secretary
BRIAN J. MOLINE, General Counsel

State Corporation Commission
Fourth Floor, State Office Bldg.
Ph. 913 296 3355
TOPEKA, KANSAS 66612

November 25, 1981

The Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

RE: Proposed repeal of the Public Utility Holding Company Act (PUHCA).

Dear Congressman Corcoran:

In your letter of October 27, 1981, you state that you are interested in possible changes to the Public Utility Holding Company Act (PUHCA) as one approach to removing regulatory barriers that may inhibit the ability of utilities to "financially help themselves and their stockholders and ratepayers." Implicit in any approach to repeal or limit the scope of PUHCA is the assumption that diversification or expansion in the utility industry is either necessary or beneficial to the financial health of the utility industry. The validity of this assumption is untested; this assumption ignores the reality that most utilities could best improve their financial situation through more efficient use of resources presently available. The examples of steps to be taken in this direction include: enchanced load management and increased interconnects. The objectives of conservation and more efficient use of current generating equipment should take priority over diversification if the utility industry is to achieve long-term financial stability.

The multi-state Holding Company poses threats to effective State regulation in two ways. First, the holding company device may be used to escape jurisdiction of states which have no statutory authority over holding companies. Kansas has resolved this problem by passage of its own Utility Holding Company Act, K.S.A. 66-1401 et seq., giving this Commission jurisdiction over affiliated interests and holding companies for purposes of rate-making and contract review. The second and more real threat is the practical problem of addressing large holding companies effectively given the limitations of state regulatory commissions. Most state commissions have relatively small staffs and limitations upon the time in which they are allowed to hear cases and render decisions. Within these constraints it is very difficult, if not impossible, for a state commission to regulate in any meaningful way a large utility with many diverse affiliates.

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The Public Utility Holding Company Act serves as a safeguard for the interest of State regulation of utilities. PUHCA tends to limit the size of holding companies and tends to limit holding companies to specific contiguous geographic areas. These limitations keep utilities within the practical and jurisdictional reach of State agencies. With these general statements in mind, I turn now to the specific questions posed by your letter.

Approach No. 1.

Outright repeal of PUHCA does not appear to serve the best interest of State Utility Regulation. Repeal of PUHCA would open the door for the creation of utilities large enough to be beyond the ability of review of the state commissions. In some cases states may not have jurisdiction over large holding companies; efforts by states to limit or prohibit the creation of large holding companies would result in a patchwork of regulation and tend to discourage diversification by utilities. Although the size of electric and gas utilities does not currently pose a problem for state regulation, this Commission's experience suggests that state commissions do not have the resources to regulate a company such as AT&T and its affiliated interests.

One can safely assume that most of the public hold no strong opinions on whether holding companies should be regulated at the State or Federal level. The public is aware of the shifting responsibility from the Federal to State governments generally, and the public is acutely aware of higher utility bills. At the same time, there is no evidence that the public is willing to pay the cost of increased State regulatory responsibility that would result from requiring states to regulate utility holding companies. For these reasons, an outright repeal of the PUHCA would be undesirable from a State regulator's perspective.

Approach No. 2.

The second approach appears to reach a similar result. The provision exempting holding companies created by companies presently exempt under Section 3(a)(2) of the Act would allow virtually any utility not presently subject to PUHCA to create a holding company, and thereby escape provisions of PUHCA. Removal of the "unless and except" clause; of course, would require exemption of such holding companies whether in the public interest or not. Such provisions would have the effect of de facto repeal of PUHCA concerning companies not currently subjected to its provisions.

The same objections offered above to the first approach apply here. Under Approach No. 2 states would be compelled to

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enact their own statutes governing holding companies in order to continue effective regulation of utilities in their respective jurisdictions. Once again, irregularities would arise in the regulation of holding companies, uncertainty of the government regulatory environment would increase, and diversification would be discouraged.

The attempts to limit the effects of the Public Utility Holding Company Act are undesirable from the State Regulator's perspective. Furthermore, it appears the approach as suggested in your letter would not achieve the objectives of encouraging diversification in the utility industry. To reiterate, the problems of the utility industry will not necessarily be addressed by enhancing the environment for diversification and expansion. William E. Wall, Chairman, of Kansas Power and Light Company, recently stated: "There is nothing wrong with any electric utility that a fair rate of return would not cure." Repeal of the Public Utilities Holding Company Act at this time would be unfortunate.

Sincerely,

R. C. (Pete) Loux, Chairman
Kansas Corporation Commission

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STATE OF DELAWARE
THE PUBLIC SERVICE COMMISSION
1560 SOUTH DUPONT HIGHWAY
DOVER, DELAWARE 19901

November 24, 1981

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D.C. 20515

01

Re: Public Utility Holding Co. Act of 1935 (PUHCA)

Dear Representative Corcoran:

You have requested my comments as a State regulator concerning possible modifications to the 1935 Act (PUHCA).

I share your concern about statutory and regulatory barriers which may inhibit the ability of utilities to financially help themselves and their stockholders and ratepayers. However, I am equally concerned that well intentioned revisions do not significantly and adversely impact the abilities of State regulators to effectively act in the public interest.

In Volume 2 of his "Principles of Public Utility Regulation" on page 507, the noted author, A. J. G. Priest, introduces his chapter on the PUHCA with the following comments:

> "The Public Utility Holding Company Act of 1935 (15 U.S.C. §§79-79Z (1964) was a major legislative achievement of the New Deal. It was: (1) highly controversial, (2) strongly resisted (e.g. §11, the so-called 'death sentence' which provided for the simplification of holding company systems, passed the Senate by a single vote), (3) so admirably drafted that all attacks on its constitutionality vaporized and that only three of its sections (§18, 24, and 25) have been subjected to amendments (all of them minor), and (4) patently (hindsight never fails) in the public interest."

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This legislation was obviously a carefully considered response to serious regulatory problems.

It may well be that the current economic realities provide the basis for consideration of revisions to the Act; however, I would sincerely hope that proposed solutions to the financial and growth problems of utilities fully consider and not reintroduce in a new form the management, accounting, and financing abuses which were designed to be corrected by the original legislation.

In short, modification of PUHCA may provide increased financing flexibility, will most probably foster and promote diversification, and should not do either without the proper controls to insure the continued provision of high quality public utility service at reasonable rates.

Very truly yours,

Joshua W. Martin, III
Chairman

JWM/njs

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Public Utility Commission of Texas

November 30, 1981

George M. Cowden
Chairman

H. M. Rollins
Commissioner

Garrett Morris
Commissioner

The Honorable Tom Corcoran
The United States House of Representatives
Washington, D.C. 20515

Dear Mr. Corcoran:

Chairman Cowden has asked me to respond to your letter of October 27, 1981 concerning the possibility of repealing or amending the Public Utility Holding Company Act of 1935 (PUHCA). Before discussing the possible advantages and disadvantages that might result from repeal of the PUHCA, I will begin with a brief description of the current situation in the State of Texas in so far as it relates to this legislation.

The Public Utility Regulatory Act of June 1975 which created this Commission gives it broad authority for ratemaking purposes over utility company transactions with affiliated interests. The Act gives the Commission the authority to determine the reasonableness of all payments to affiliated interests and states that the price to the utility should be no higher than prices charged to other affiliates or unaffiliated parties. Interest and capital costs are specifically mentioned in this section.

Therefore, under our Act, the Commission currently has the authority to prevent abuses by members of holding companies in this one area. However, the Commission does not have the authority to regulate the issuance of securities or the payment of dividends by utility companies under its jurisdiction. Therefore, repeal of the PUHCA would leave these two activities unregulated for utility companies in Texas.

Texas is currently the only state in the continental United States that is not interconnected with other states. Several electric utilities in Texas are members of the Economic Reliability Council of Texas (ERCOT) and have been unwilling to interconnect with other regional power pools. Repeal of PUHCA itself may not be sufficient to overcome this unwillingness. Other aspects of federal regulation would have to be addressed in order to foster greater cooperation between ERCOT and other regional power pools.

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At present most electric utilities in Texas are engaged in large-scale construction programs designed to convert from oil and gas powered units to coal and nuclear energy. Also, Texas electric utilities face a higher than average growth in peak demand over the next two decades. These facts mean that Texas electric utilities will continue to have extremely large capital requirements through the remainder of this century.

In light of this background, I will briefly review the possible benefits and negative consequences of repealing or amending the PUHCA. The Commission Staff is now in the process of studying various proposals for the deregulation of the electric utility industry. Preliminary research has shown that a restructuring of the industry that would facilitate economies of scale, especially the coordination of the planning, construction and dispatch of plants over broad areas, might be highly beneficial to the national economy. However, we have not determined whether repeal of the PUHCA or some other legislative action would be the best way to achieve this goal.

Diversification of the industry could be a two-edged sword. It might serve to strengthen the industry financially, or it might prove to be injurious to utility customers if companies siphon resources away from utility services to other, more profitable businesses. I should note here that Texas utilities have continued to enjoy good access to the capital markets primarily because they have been able to maintain their financial health.

Several negative consequences of repealing or amending PUHCA also should be noted. One that is of particular concern to us here in Texas is the question of whether an unregulated parent company will continue to make the large-scale investment required to maintain and expand utility service in our rapidly growing state. We have experienced this problem first hand in the telephone area. In its last two rate cases before this Commission, the rate of return on equity to General Telephone Company of the Southwest (GTSW) was lowered because of the poor quality of service provided to Texas customers. A major factor contributing to the poor quality of service and inadequate equipment in Texas was thought to be insufficient investment over the years by the parent company, General Telephone and Electronics Corporation, in its Texas subsidiary. The possibility that this phenomenon could reoccur with frequency if the holding company structure proliferated is a source of concern to us.

Another aspect of this problem is that repeal of the PUHCA would undoubtedly make our job as the local regulatory authority more complex. If utilities were part of large, complicated corporate structures, they would be more difficult to regulate. In particular, there is the potential problem of the cross subsidization of competitive services by noncompetitive services. This has proved to be one of the most difficult issues in the deregulation of the telecommunications industry.

We at the local level are also concerned about the possible use of scarce capital resources for mergers and acquisitions unrelated to utility service. Also, will parent company management be as responsive to local needs for utility services as companies headquartered in Texas or in neighboring states?

In conclusion, there appear to be both potential benefits and problems associated with the deregulation and restructuring of the electric utility industry. Repealing or amending the PUHCA may have beneficial effects on the financial health of the industry by expanding its capital market appeal. However, repeal of the PUHCA could have serious negative consequences, particularly in the area of maintaining high quality utility service in an increasingly complex corporate environment. We as state regulators would like to see more research on the possible consequences of such legislation before we can accurately assess its potential benefits to our ratepayers in Texas.

Sincerely,

John E. Cunningham

John E. Cunningham
Director of Public Utilities

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STATE OF INDIANA
PUBLIC SERVICE COMMISSION
801 STATE OFFICE BUILDING
INDIANAPOLIS 46204

December 2, 1981

The Honorable Tom Corcoran, M.C.
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

My apologies in being so long in replying to your letter of October 27, 1981. At a meeting of the National Association of Regulatory Utility Commissioners (NARUC) in San Francisco last month your letter, which was apparently sent to the Chairman of many, if not all, state utility commissions, was discussed. As you may know, the NARUC has formed an Ad Hoc Committee to study the issue of diversification. While the questions posed by the attachment to your letter do not deal solely with diversification, nevertheless the work product of the study committee will be relevant to most of the issues raised in your letter and attachment. It therefore seemed to be the consensus at the NARUC Executive Committee meeting that the NARUC should attempt to answer your letter after further deliberation by its Executive Committee following a report of its Ad Hoc Committee on Diversification.

In the meantime, although some state commissions may prefer to defer to the NARUC generic review, state commissions may still wish to respond to those questions you raised dealing with state specific situations. Insofar as this state commission is concerned, I would prefer waiting to answer your letter until the NARUC Ad Hoc Committee on Diversification has completed its work, especially since I am the member of that Ad Hoc Committee charged with the specific responsibility of concentrating on the effect of diversification on the electric utility industry. I would, however, like to make one observation now that I doubt would be changed by the outcome of the NARUC study: I do not believe the implied assumption in question 4 of the attachment to your letter that the public has more confidence in federal regulation than it does in state regulation is justified.

Yours truly,

Larry J. Wallace
Chairman

gk
cc: The Honorable Stanley York, Chairman, Wisconsin Public Service Commission and Chairman of NARUC Ad Hoc Committee on Public Utility Diversification
Paul Rodgers, NARUC

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COMMISSIONERS
FORD B. SPINKS, CHAIRMAN
MAC BARBER, VICE CHAIRMAN
JIM HAMMOCK
BILLY LOVETT
ROBERT C. (BOBBY) RAFFORD

DEC 7 1981

HUGH S. JORDAN, SECRETARY

Georgia Public Service Commission
244 WASHINGTON STREET, S.W.
ATLANTA, GEORGIA 30334

December 3, 1981

The Honorable Tom Corcoran
Representative in Congress
Illionis Office
205 North Lake Street
Aurora, Illinois 60506

Dear Representative Corcoran:

Please excuse the delay in my response to your letter received November 6, 1981.

The PUHCA has had little direct effect upon State regulation in Georgia since it primarily prohibits and restricts activities of holding companies. Therefore, repeal would have little effect on State regulation. We have successfully regulated telephone holding companies and their subsidiaries without a PUHCA and can do the same with electrics.

Approach Two would not affect Georgia at all because we do not have a one subsidiary holding company.

Please let us know if we may be of further assistance.

Yours very truly,

Ford B. Spinks
Chairman

FBS:rs

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TOM CORCORAN
13TH DISTRICT, ILLINOIS

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS

POST OFFICE AND CIVIL SERVICE COMMITTEE
SUBCOMMITTEE ON HUMAN RESOURCES
SUBCOMMITTEE ON POSTAL OPERATIONS AND SERVICES

Congress of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE:
1107 Longworth House Office Building
Washington, D.C. 20515
(202) 225-2976

ILLINOIS OFFICES:
203 North Lake Street
Aurora, Illinois 60506
(312) 897-2230

100 West Lafayette Street
Ottawa, Illinois 61350
(815) 434-5666

Illinois Toll-Free Action Line:
(800) 942-0837

January 25, 1982

The Honorable Michael V. Hasten
Chairman, Illinois Commerce Commission
160 North LaSalle Street
Chicago, Illinois 60601

Dear Mike:

Thank you for your December 7, 1981, letter concerning my legislative efforts in connection with the Public Utility Holding Company Act of 1935. I know that you share my concern about the serious financial difficulties that this country's utilities are experiencing.

The Holding Company Act was enacted in 1935 in response to claims of financial abuses by the utility industry. At the time, the industry was characterized by large, nationwide holding companies that engaged in questionable financial and accounting practices. In the course of its administration of PUHCA, the Securities and Exchange Commission identified two goals: 1) simplification of the financial and corporate structures of such public utility holding companies and limitation of their activities to those of a single, integrated public utility system; and 2) regulation of the financial operations and accounting practices of those holding companies. The first goal, simplification, was achieved by 1955 through the forced divestiture of properties mandated by Section 11 of PUHCA. Second, I am told that the Securities Act of 1933 and the Securities Exchange Act of 1934, together with developments in the accounting profession, have proven to be effective in eliminating the financial and accounting practices that led to the passage of the Act. In addition, I am sure that you would agree that state regulation of public utilities is much more effective today that it was in 1935. As a result, I would think that there is little, if any, likelihood that the abuses the Act was designed to prevent could recur.

In fact, as you may know, in a December 17, 1981, 5 - 0 decision, SEC recommended that the Act be repealed, mainly for the reasons I have just outlined.

I believe that a number of utilities would be interested in using a holding or parent company structure with separate utility and non-utility subsidiaries as the preferred or optimum stucture to use in connection with their diversification into non-utility businesses. It is my understanding that the reason for this structure is not to avoid state regulation, but rather to provide for a clearer separation of utility assets from non-utility assets. The utility subsidiary would remain fully subject to state regulation.

It is important to improve the financial condition of the utility industry in order to attract capital on more reasonable terms. The problem, of course, stems from the fact that, in recent years, investors that traditionally have invested in utility securities have witnessed a proliferation of more attractive, alternative investment opportunities. I introduced H.R. 5220, the "Public Utility Financial Reform Act", on December 15, 1981, to facilitate diversification and, thus, to make utility securities more attractive investments without directly raising rates to consumers.

With the cooperation of Reid & Priest, with whom I have been working on this issue, I am enclosing copies of memoranda prepared by them in connection with PUHCA. If you have any further comments, please feel free to contact me or Al Cobb of my staff, or, if you so desire, please feel free to contact Richard M. Farmer of Reid & Priest, particularly in connection with technical issues.

Sincerely,

Tom Corcoran
Representative in Congress

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STATE OF ILLINOIS

Illinois Commerce Commission

MICHAEL V. HASTEN
CHAIRMAN

160 NORTH LA SALLE STREET
CHICAGO, ILLINOIS 60601

December 7, 1981

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DAN'S NOTES aj

The Honorable Tom Corcoran
Member of the United States Congress
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

Thank you for the opportunity to comment on the current legislative initiatives involving repeal or amendment of the Public Utility Holding Company Act of 1935 (PUHCA). I share your concern over the short and long term financial condition of the electric utility industry on a national basis. The maintenance of the integrity of the financial condition of utilities is and should be for the benefit of utility investors as well as ratepayers, current and future, who will require utility service from companies which are able to provide it at the lowest possible cost. However, the legislative initiatives which may result in the repeal or significant amendment of the PUHCA raise concerns regarding the clear and unequivocal need to protect investors and ratepayers from holding company abuses.

The passage of the PUHCA in 1935 was largely precipitated by blatant abuses at that time, and it is my opinion that that Act has served the public well in providing Congressionally mandated protection. If only because state public utility commissions generally lack both jurisdictional authority and resources to deal effectively with multistate holding companies, I would not favor repeal of the Act. Further, the Securities and Exchange Commission (SEC) has served the public well through its evenhanded approach to the implementation and enforcement of PUHCA, and it is doubtful that these functions can be absorbed by the many states which have holding companies subject to the Act.

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Collaterally, the issue of utility diversification is currently much in vogue. Although I personally have no bias for or against diversification, I have, as an economic regulator, serious concerns about unbridled, unregulated diversification which, if left unchecked, could inure to the detriment of not only current and future investors, but also ratepayers of public utilities. I think it necessary that regulators have the tools available to them to be sure, when they examine such proposals, that diversification plans have sufficient safeguards to protect ratepayers and investors from abuse.

It appears that the organization of a holding company by a utility for the purpose of diversification through a non-utility subsidiary may be a device to avoid state regulation altogether. This is dangerous and clearly not in the public interest. Proposed amendments to Section 3 of the Act would eliminate Federal restraints as well from such a holding company. Since these amendments do not appear to be founded on public interest arguments, I cannot support their enactment. Moreover, I would be significantly dismayed to find the United States Congress an instrument in this effort to escape state regulation.

Finally, it is my understanding that the PUHCA now provides the SEC with adequate discretionary authority in its implementation to accomodate the changing size and structural complexity of the electric utility industry.

I think it interesting to note that some are arguing that the PUHCA is superfluous. That argument strikes me as significant in itself to support the Act's effectiveness and the need for its continued existence without significant amendment.

If I can be of any further assistance to you or if you are in need of any other information on the subject, please do not hesitate to contact me at your convenience.

Very truly yours,

Michael V. Hasten
Chairman

MVH/rn

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STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL

December 8, 1981

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DAN'S NOTEBOOK

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
Washington, D. C. 20515

Dear Representative Corcoran:

I am responding to your recent letter on revisions to our appeal of the Public Utility Holding Company Act with some very preliminary observations. Should specific proposals or draft legislation be formulated, our agency would be able to provide you with a more careful analysis and a reasoned evaluation.

Based on the limited information provided, however, we would offer the following comments:

APPROACH ONE

Question 1: The problems of size and structural complexity of utility companies organized under a holding company have increased in proportion to the increased complexity of corporate finances and to the increased complexity of the national energy picture.

The appropriate question in regard to a proposed repeal of the PUHCA is to what extent the current size and structural complexity of utility company organizations would increase without the PUHCA. While any answer to that question would be speculative, it is probable that the size and complexity of utility company organizations would increase exponentially.

Question 2: State law could not adequately protect stockholders and ratepayers from the problems addressed by the PUHCA because that Act was specifically aimed at holding companies which exploited the interstate character of their operations to defeat state regulation.

Question 3: Conflicting state regulation would most probably follow repeal of the PUHCA because today's climate of rising

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energy costs and falling energy supply would lead each state to be overly protective of its interests.

Question 4: Public confidence in state PUC regulation means little if the state is powerless to protect its citizens from interstate abuses.

Question 5: If diversification means a single unregulated corporate structure entering into more than one energy supply field, then diversification means increased consolidation and monopolization which, traditionally, have been contrary to the public interest. This type of diversification could increase without the PUHCA.

APPROACH TWO

Question 1: This approach could lead to the diversification outlined in the answer to Approach 1, Question 5. The fact that a holding company's subsidiaries were limited in operation to the state of incorporation and contiguous states would not significantly ease the problems arising from the interstate nature of the holding company's business. A blanket exemption from the PUHCA for such operations could invite abuses to the public interest.

Question 2: The same answer to Approach 1, Question 5 is applicable here.

I hope these comments are helpful to you, and that you will give us the opportunity to comment again should a specific proposal be drafted.

Very truly yours

Thomas H. Fitzpatrick
Chairperson

THF:jh

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IOWA STATE COMMERCE COMMISSION

LUCAS BUILDING
DES MOINES, IOWA 50319

Commissioners
Andrew Varley
Fred H. Moore
Christine A. Hansen
Executive Secretary
Robert G. Holetz

December 14, 1981

The Honorable Tom Corcoran
Congress of the United States
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

RE: Letter of October 27, 1981, concerning the Public Utility Holding Company Act

Dear Representative Corcoran:

Thank you for your above-referenced letter of October 27, 1981. Our staff is presently reviewing this matter in anticipation of some type of Public Utility Holding Company Act legislation. We believe existing law provides important protection to consumers and we would discourage repeal at the federal level.

We welcome the opportunity to submit comments to your Subcommittee once legislation concerning this subject matter has actually been introduced and we have the opportunity to evaluate specific proposals.

Thank you for your time and consideration.

Very truly yours,

Andrew Varley
Chairman

BS:lks

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JAN 11 1982

PUBLIC SERVICE COMMISSION
STATE OF NEVADA

Address all communications to the Commission
Telephone (702) 885-4180

January 6, 1982

KINKEAD BUILDING
505 E. KING STREET
CARSON CITY, NEVADA 89710

Honorable Tom Corcoran
Representative in Congress
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Tom:

I appreciate your recognition of the financial plight of the nation's public utilities and their ability in the future to meet the energy demands of the American public. It is satisfying to know that there are members of Congress who are attuned to this reality.

Concerning your amendment to Section 3 of the Public Utility Holding Company Act; it must be recognized that some type of realistic financial relief is needed for the nation's utilities, and at the same time keeping in mind their ability and flexibility in providing viable energy resources. It is evident that you address this exact situation with the concern of investors and consumers (ratepayers) in mind. Your amendment, as I read it, adequately protects against cross-subsidization between the utility business and non-utility business, when entering into diversification.

From my point of view, that of Financial Analyst for the Public Service Commission of Nevada, this type of legislation, as you have addressed it, is of vital concern to affordable and available energy for consumers. Finally, it is a step in providing the public utilities the opportunity to earn a realistic rate of return needed in order to attract investors' capital into the industry.

Thank you again for your efforts in Congress.

Sincerely,

PUBLIC SERVICE COMMISSION OF NEVADA

STEVE RIGAZIO
Financial Analyst

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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION
100 Orange Street
Providence, R.I. 02903

January 4, 1982

The Honorable Tom Corcoran
House of Representatives
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Corcoran:

Thank you for enclosing in your letter of December 23, 1981, a copy of H.R. 5220, the "Public Utility Financial Refort Act."

Please be advised that the National Association of Regulatory Utility Commissioners has established a special committee which is investigating the entire issue of public utilities diversification, and I will specifically instruct them to review your enclosed legislation.

In the meantime I am referring to you a copy of the speech delivered by Rhode Island's Governor J. Joseph Garrahy at a recent convention of NARUC. I call your attention specifically to those portions of his speech which deal with the subject of the Public Utilities Company Holding Act of 1935 and the extreme care that must be taken relative to amendments to the Act. I fully share Governor Garrahy's views.

Sincerely,

Edward F. Burke

Edward F. Burke
Chairman

EFB:lls
Enclosure

cc: Mr. Paul Rodgers, NARUC
The Honorable Stanley York, Chairman
Wisconsin Public Utilities Commission

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Robert W. Bratton, Chairman
Robert C. Bailey, Commissioner
Aldo J. Benedetti, Commissioner

STATE OF WASHINGTON
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
Highways Licenses Building • Olympia, Washington 98504 • (206) 753-6423 • (SCAN) 234-6423

January 11, 1982

The Honorable Tom Corcoran
Member of Congress
1107 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Corcoran:

Thank you for sending us copies of information concerning H.R. 5220, the "Public Utility Financial Reform Act."

There are no registered holding companies which operate in the State of Washington. We do have some companies which operate under PUHCA exemptions. The state derives some benefit from the exempt status of those holding companies because SEC review of capitalization is still required for exempt companies. Since we only regulate the operations of the utility subsidiaries it is helpful to have review of the complete holding company capitalization by another agency.

Therefore, we would urge the continuation of that review function in the revisions to the holding company act. Beyond that we certainly commend your efforts to improve this legislation and eliminate unnecessary regulatory burden.

Thank you for providing us an opportunity to comment on the proposal.

Sincerely,

Robert W. Bratton
Chairman

RWB:dd

cc: NARUC

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State of Florida

Joseph P. Cresse
Chairman

FLETCHER BUILDING
101 EAST GAINES STREET
TALLAHASSEE 32301
(904) 488-2986

Public Service Commission

December 4, 1981

The Honorable Tom Corcoran,
Representative
House of Representatives
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

Thank you very much for your letter of October 27, 1981. The request for information that you have made is of a highly complex nature. I am having staff prepare a response to your inquiry. Particularly, I have asked them to address both the legal and the technical impact of the repeal of the Public Utility Holding Company's Act of 1935.

In this regard, they will analyze both approach one and two you propounded in your request. I hope that this delay will not endanger your legislative effort.

Sincerely yours,

Joe Cresse

Joseph P. Cresse
CHAIRMAN

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State of Florida

Joseph P. Cresse
Chairman

FLETCHER BUILDING
101 EAST GAINES STREET
TALLAHASSEE 32301
(904) 488-2986

Public Service Commission

January 14, 1982

Honorable Tom Corcoran
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Thank you for sending along the information concerning HB 5220, your bill to amend the Public Utility Holding Company Act (PUHCA).

This Commission shares your desire to enhance the financial health of electric and gas utility companies and is in agreement that the problems which gave rise to PUHCA in the 1930's are not likely to recur. We are in favor of allowing utility companies to diversify so long as the issue of cross-subsidization between parent and subsidiary can be effectively addressed. The appropriate allocation of risk between stockholders and ratepayers is of primary concern to the Commission and we would favor measures to allow state regulatory authorities access to information held by the non-regulated entity for this purpose.

The opportunity to comment on your well-reasoned proposal is greatly appreciated. Feel free to call on us for any further assistance we can provide.

Sincerely,

Joseph P. Cresse

JPC:CLS:brf

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1982

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ARKANSAS
PUBLIC SERVICE COMMISSION
P.O. Box C-400
Markham & Victory Streets
LITTLE ROCK 72203

N.M. Norton, Jr.
Chairman
Sandra W. Cherry
Commissioner
Walter Skelton
Commissioner

February 1, 1982

Tom Corcoran
Representative in Congress
1107 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Corcoran:

Thank you for your letter of December 23 relaying the changes you proposed to the Public Utility Holding Company Act in the form of H.R. 5220, the Public Utility Financial Reform Act. As you noted such legislation is of interest not only to me but to all those who serve the public through utility regulation.

Of particular interest to this Commission is the diversification by utilities into non-utility areas of investment in order to solve their current financial predicaments. This might not only aid the utility but alleviate some of the burden now being placed upon the ratepayer as well, in the long run.

Please keep me apprised of the status of H.R. 5220 and do not hesitate to call upon me in the future. I look forward to hearing from you.

Sincerely,

N. M. Norton, Jr.

NMN/mam

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Congressional Record

H 9697

December 15, 1981

THE PUBLIC UTILITY FINANCIAL REFORM ACT

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Illinois (Mr. CORCORAN) is recognized for 10 minutes.

● Mr. CORCORAN. Madam Speaker, I am today introducing the Public Utility Financial Reform Act. The bill would amend section 3 of the Public Utility Holding Company Act of 1935 to facilitate diversification by electric and gas utilities into more profitable, nonutility businesses.

This country's utilities are experiencing serious financial difficulties which, if allowed to continue, would have a devastating impact upon the Nation and its citizens and industry dependent upon reliable electric and gas utility service.

As many of us know, the common stocks of electric utilities are selling well below their book values, and lowered bond ratings have resulted in higher interest charges that are ultimately passed on to consumers. These factors have caused the utility industry, as well as other concerned citizens, to explore the possibilities of diversification as a means of improving the industry's financial performance and stability and contributing to the well-being of the Nation's energy resources.

The act was passed in 1935 to correct a series of abuses by electric and gas utility holding companies, notably excessive pyramiding of corporate structures and stock watering. At the time, a handful of holding companies controlled virtually the entire utility business in the Nation. These holding companies operated in disparate parts of the country and were not subject to effective State regulation.

In the view of the Congress, the power and interstate character of these holding companies rendered State control over such abuses ineffective and required that authority over them be conferred upon the Securities and Exchange Commission. The principal purpose of the act, as noted in the legislative history, was to insure effective State regulation by reorganizing these holding companies into geographically contiguous units. Virtually all of the questionable practices the act was designed to correct were securities and accounting ones, not unique to the utility industry. As such, they probably would have been eliminated over time by the then-new Securities Act of 1933 and the Securities Exchange Act of 1934, both of which turned out to be far more effective than anticipated. Accounting standards and practices have improved dramatically since the mid-1930's. Moreover, the regulation of public utilities on the State level is considerably more effective today than when the act was passed, since State utility laws have now evolved into strong, comprehensive regulatory systems. Thus, present Federal and State regulation is drastically different from that of the early 1930's, and there is little likelihood those problems would recur in the face of regulatory scrutiny under Federal and State laws other than the act.

The bill allows both independent electric and gas operating companies to form exempt holding companies; it also allows exempt holding companies to diversify without later being subject to arbitrary SEC revocation of their exemptions. The bill would apply to all electric and gas utilities with the exception of registered holding companies.

I recognize that there are a number of issues relating to utility diversification and the act that need to be addressed. I hope introduction of this legislation will encourage early hearings on this subject. Earlier this year, hearings on the subject of least cost energy strategies for the utility industry were held by Chairman OTTINGER's Energy Conservation and Power Subcommittee. In fact, it was at a September 10 hearing of that subcommittee that I first discussed the possibility of the need for the Congress to consider the impact of the act on the financial health of the utility industry. Subsequently, I sent a questionnaire regarding the act to approximately 150 utility executives and each of the 50 State public service commissions.

In reviewing the act, we must look at the likely impact of diversification on investors and consumers alike. Secondly, one must view utility diversification in the context of the Nation's overall energy posture and the development of its renewable and alternative energy resources. Finally, we should address specific questions that may be of concern to regulators and investors alike, such as whether the holding company structure, with separate corporate subsidiaries for utility and nonutility businesses, as provided in the bill, adequately protects against cross-subsidization between the utility business and the nonutility business and possible competitive effects in the marketplace, particularly among small businesses.

Madam Speaker, I consider the financial health of the utility industry to be an important issue. I look forward to further addressing this matter in the ensuing months.

By Mr. CORCORAN:

H.R. 5220. A bill to amend the Public Utility Holding Company Act of 1935 to improve financial performance of electric and gas utilities by removing unnecessary regulatory impediments to the exercise of sound and prudent business judgment by utility executives; to the Committee on Energy and Commerce.

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Madam Speaker, for the benefit of our colleagues, I would like to include in the RECORD at this point the text of the "Public Utility Financial Reform Act."

H.R. 5220

A bill to amend the Public Utility Holding Company Act of 1935 to improve financial performance of electric and gas utilities by removing unnecessary regulatory impediments to the exercise of sound and prudent business judgment by utility executives

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

Section 1. This Act may be cited as the "Public Utility Financial Reform Act".

FINDINGS

Sec. 2. The Congress hereby finds that—

(1) the electric and gas utility industries in the United States, once strong and stable, are now experiencing serious and intractable financial difficulties, the consequences of which threaten the existence of these vital national resources, together with the citizens and industry of the United States dependent thereon;

(2) while there may be a number of alternatives available to remedy the financial difficulties confronted by the electric and gas utility industries, it is in the best interests of investors and consumers to encourage the most expeditious of those financial remedies;

(3) the diversification of a business portfolio, when done prudently, is recognized as both as technically and operationally sound means of improving corporate financial performance by spreading or countering business risk;

(4) prudently managed diversification into nonutility businesses is a normal business practice that could substantially improve the financial performance of certain electric and gas utilities;

(5) it is in the public interest to remove unnecessary and unintended regulatory impediments to the exercise of sound and prudent business judgment by utility executives;

(6) the Public Utility Holding Company Act of 1935 was intended to correct abuses in the manner in which the utility industry was then conducting its affairs; the legislative intent was not, however, to prevent or interfere with those normal and prudent business practices the benefits of which would accrue to both investors and consumers;

(7) certain provisions of the Public Utility Holding Company Act of 1935 nevertheless act to increase, rather than decrease, business risk in a manner that is detrimental to the interests of investors and consumers by effectively discouraging diversification by electric and gas utilities into non-utility businesses; and

(8) the amendment of the Public Utility Holding Company Act of 1935 to provide for the establishment of a new exemption for holding companies with a subsidiary public-utility company meeting certain defined criteria and the establishment of definitive exemptions would be consistent with the public interest and the interests of investors and consumers and would eliminate those provisions which inhibit normal and prudent business practices.

STATEMENT OF PURPOSES

Sec. 3. The purposes of this Act are—

(1) to facilitate diversification by removing technical restrictions imposed by the Public Utility Holding Company Act of 1935 on those utilities prudently operating in the best interests of their investors and consumers that find it desirable and beneficial to diversify their business activities;

(2) to provide a new exemption under section 3 for a holding company with one subsidiary public-utility company that operates in one or more States contiguous to the State in which such subsidiary public-utility company is organized;

(3) to provide an exemption for holding companies created by companies that are presently exempt under section 3(a)(2) of the Public Utility Holding Company Act of 1935; and

(4) to provide definitive exemptions in subsection (a) of section 3 so as to reduce the regulatory impediments of the exercise of prudent business judgment related to diversification by such utilities.

AMENDMENTS TO THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Sec. 4. Section 3 of the Public Utility Holding Company Act of 1935 is amended to read as follows:

"POWER TO MAKE PARTICULAR EXEMPTIONS REGARDING HOLDING COMPANIES, SUBSIDIARY COMPANIES, AND AFFILIATES

Sec. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall unconditionally exempt any holding company, and every subsidiary company thereof as such, from all provisions of this title, except paragraph (2) of subsection (a) of section 9, if—

"(1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;

"(2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;

"(3) such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public-utility company and (A) not deriving, directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public-utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all the outstanding securities of such companies are owned, directly or indirectly, by such holding company;

"(4) such holding company is temporarily a holding company solely by reason of the acquisition of securities for purposes of liquidation or distribution in connection with a bona fide debt previously contracted or in connection with a bona fide arrangement for the underwriting or distribution of securities;

"(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public utility company; or

"(6) such holding company has only one subsidiary public-utility company and such subsidiary public-utility company's operations as such do not extend beyond the State in which it is organized and States contiguous thereto.

"(b) If a holding company otherwise qualifies for an exemption pursuant to subsection (a) of this section, that exemption shall not be affected by the ownership by a public-utility subsidiary of such holding company of a public-utility company provided that the ownership of such public-utility company by the public-utility subsidiary of such holding company is exempt pursuant to paragraph (2) of subsection (a) of this section.

"(c) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any subsidiary company, as such, of a holding company from any provision or provisions of this title, the application of which to such subsidiary company the Commission finds is not necessary in the public interest or for the protection of investors, if such subsidiary company derives no material part of its income directly or indirectly, from sources within the United States, and neither it nor any of its subsidiary companies is a public-utility company operating in the United States.

"(d) Within a reasonable time after the receipt of an application for exemption under subsection (a) or (c), the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of such application. The filing of an application in good faith under subsection (a) by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon such application. The filing of an application in good faith under subsection (c) shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a subsidiary company, until the Commission has acted upon such application. Whenever the Commission on its own motion, or upon application by the holding company or any subsidiary company thereof exempted by any order issued under subsection (a), or by the subsidiary company exempted by any order under subsection (c), finds that the circumstances which gave rise to the exemption no longer exist, the Commission shall by order revoke such order.

"(e) The Commission may, by rules and regulations, conditionally or unconditionally exempt any specified class or classes of persons from the obligations, duties, or liabilities imposed upon such persons as subsidiary companies or affiliates under any provision or provisions of this title, and may provide within the extent of any such exemption that such specified class or classes of persons shall not be deemed subsidiary companies or affiliates within the meaning of any such provision or provisions, if and to the extent that it deems the exemption necessary or appropriate in the public interest or for the protection of investors or consumers and not contrary to the purposes of this title.

"(f) A holding company which is exempt under subsection (a) of this section may engage in any business (or businesses) whether or not any such business is incidental or necessary to the operation of a public-utility company, but any such business (or businesses) which is not incidental or necessary to the operation of a public-utility company shall be conducted through a separate non-utility subsidiary (or subsidiaries) of such holding company."●

By Mr. CORCORAN:

H.R. 5220. A bill to amend the Public Utility Holding Company Act of 1935 to improve financial performance of electric and gas utilities by removing unnecessary regulatory impediments to the exercise of sound and prudent business judgment by utility executives; to the Committee on Energy and Commerce.

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TOM CORCORAN
17th District, Illinois

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS

POST OFFICE AND CIVIL SERVICE COMMITTEE
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December 18, 1981

The Honorable John S. R. Shad
Chairman, Securities and
Exchange Commission
Washington, DC 20549

Dear Mr. Chairman:

December 15, I introduced H.R. 5220, the "Public Utility Financial Reform Act". This legislation would amend the Public Utility Holding Company Act of 1935, a law over which SEC has jurisdiction.

As you can see from the enclosed information, I am proposing that Section 3 of PUHCA be amended. However, I am very interested in considering any other approaches, including total repeal, that might be appropriate and would be pleased to receive any comments you might have about this legislation. Perhaps we could meet to discuss this issue after the Second Session convenes on January 25.

Please let me know if I can be of any further assistance. Feel free to contact me or have your staff contact Al Cobb of my personal staff at 225-6106.

Sincerely,

Tom Corcoran
Representative in Congress

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OFFICE OF
THE CHAIRMAN

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
January 28, 1982

The Honorable Tom Corcoran
House of Representatives
Washington, D.C. 20515

Dear Congressman Corcoran:

On behalf of Chairman Shad, this responds to your letter of December 18, 1981, concerning H.R. 5220, which would amend the Public Utility Holding Company Act of 1935.

With regard to your letter's request for the Commission's comments on H.R. 5220, I believe that your letter of December 18 crossed in the mails with a copy Chairman Shad sent to you of his letter of December 21 to Chairman D'Amato of the Senate Securities Subcommittee (attached). That letter indicates that the Commission favors repeal of the Holding Company Act.

As your letter suggested, Peter Kiernan of my staff contacted Al Cobb of your office. Mr. Cobb indicated at that time that it might be best to defer any further discussion on this subject, including the possibility of Chairman Shad's meeting with you, until after the Congress reconvened on January 25. Now that Congress has reconvened, I simply wanted to take this opportunity to offer to be of any service to you or Mr. Cobb that I can in connection with this bill and the possible consideration of it by the Subcommittee on Energy Conservation and Power and the Committee on Energy and Commerce. Should you determine that a meeting with Mr. Shad would be helpful in this regard, please have Mr. Cobb call me or Mr. Kiernan at 272-2500; and I will do my best to arrange for it at a mutually convenient time. Please do not hesitate to let me know also if you have any questions with respect to the Commission's views on this subject or if I can otherwise be of assistance.

Sincerely,

Matthew Schneider
Director of Legislative Affairs

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Attachment

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 21, 1981

The Honorable Alfonse M. D'Amato
Chairman, Subcommittee on Securities
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, D.C. 20510

Re: Proposals to Amend the Public Utility Holding Company Act of 1935 (S. 1869, S. 1870, and S. 1871)

Dear Chairman D'Amato:

In response to a request from your staff, I am writing to advise you of the Commission's general views relating to the above three bills. These bills would substantially reduce regulation under the Public Utility Holding Company Act of 1935. The Commission, however, unanimously believes that Congress should instead repeal the Act. Based on the information available to the Commission and its experience under the Act, we believe that this statute has served its basic purpose and that continued federal regulation of utility holding companies is unnecessary and inappropriate.

The Securities and Exchange Commission has administered the 1935 Act for nearly forty-seven years. There is a consensus - shared by the Commission - that the Commission's task of reorganizing the Nation's gas and electric utility holding company systems was completed twenty years ago. The Commission's administration of the Act in more recent years has primarily involved review of registered holding company financings, mergers, and acquisitions and the consideration of requests for exemptions from the Act. These remaining Commission responsibilities are intended to prevent recurrence of the abuses which led to the original passage of the Act. The Commission believes, however, that these abuses are unlikely to recur in light of the extensive changes since 1935 in the public utility and investment banking industries, the accounting profession, state utility regulation, expansion of the disclosure requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934, and the development of more efficient and

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well-informed securities markets. If the 1935 Act is repealed, all publicly-owned utility holding company systems will, of course, continue to be subject to the financial disclosure requirements and other provisions of the federal securities laws.

Moreover, certain features of the 1935 Act set it apart from the other statutes which the Commission administers. The federal securities laws focus primarily on disclosures to investors and on the integrity of the securities markets. In contrast, acquisitions, financings, and other actions by registered public utility holding company systems require prior Commission approval under the 1935 Act. The Commission must base its approval or disapproval of these transactions on its determination of their economic merits. Thus, unlike the other statutes it administers, the 1935 Act involves the Commission very deeply in the substance of fundamental management decisions.

Only twelve active holding company systems remain subject to direct regulation under the 1935 Act. The Act, however, continues to have significant influence on the financing and diversification decisions of a much larger portion of the industry. Approximately eighty holding company systems operate under various exemptions from the Act, and many utilities may be reluctant to form holding companies because they would then have to register under the Act or qualify for an exemption. Furthermore, in this time of energy shortages and the recognized need to develop new energy resources, the Act may deter non-utilities from participating in cogeneration projects or other such activities because of the consequences of becoming subject to the Act.

The Commission finds it difficult to support any of the three legislative proposals presently before Congress because each primarily addresses only those aspects of the Act that affect one segment of the industry. Each would have the practical effect of virtually repealing the Act as it affects that particular industry segment. Taken together, the three proposals approach total repeal and would leave the Commission with responsibility for administering only the very limited surviving provisions of the Act with no clear regulatory purpose. None of the three proposals takes the further step of addressing the basic rationale for continued regulation under the Act.

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For these reasons, it is appropriate and timely for Congress to revisit the 1935 Act. Congress should not, however, limit its evaluation to the merits of these specific proposals, but should also reexamine the underlying premises of the Act to determine the extent to which those premises have continuing viability today.

Because of the importance I attach to eliminating unnecessary regulatory burdens, I wanted to inform you promptly of the Commission's general position on the pending bills. The Commission will submit a detailed, formal statement of views at an appropriate time. In the interim, if members of your staff would like additional information, they should contact our General Counsel, Edward F. Greene, or Elinor Gammon in the Office of the General Counsel.

Sincerely yours,

John S.R. Shad

cc: The Honorable Jake Garn
The Honorable J. Bennett Johnston
The Honorable John D. Dingell
The Honorable Timothy E. Wirth
The Honorable Richard L. Ottinger
The Honorable Tom Corcoran
The Honorable Harrison A. Williams
The Honorable Paul S. Sarbanes
The Honorable James T. Broyhill
The Honorable James M. Collins

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TOM CORCORAN
19TH DISTRICT, ILLINOIS

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS

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(800) 942-0637

December 18, 1981

The Honorable C. M. Butler III
Chairman, Federal Energy
Regulatory Commission
Washington, DC 20426

Dear Mr. Chairman:

On December 15, I introduced H.R. 5220, the "Public Utility Financial Reform Act". This legislation would amend the Public Utility Holding Company Act of 1935, a law over which the Securities and Exchange Commission has jurisdiction. In view of FERC's jurisdiction over various issues of concern to utilities, I thought you would be interested in this legislation.

As you can see from the enclosed information, I am proposing that Section 3 of PUHCA be amended. However, I am very interested in considering any other approaches, including total repeal, that might be appropriate and would be pleased to receive any comments you might have about this legislation. Perhaps we could meet to discuss this issue after the Second Session convenes on January 25.

Please let me know if I can be of any further assistance. Feel free to contact me or have your staff contact Al Cobb of my personal staff at 225-9106.

Sincerely,

Tom Corcoran
Representative in Congress

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FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D. C. 20426

OFFICE OF THE CHAIRMAN

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Honorable Tom Corcoran
House of Representatives
Washington, D. C. 20515

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Dear Tom:

I decided to wait until after you had returned and the Second Session had convened to answer your letter in connection with H.R. 5220. I have not reviewed your suggested legislative changes in detail. However, I would be interested to know whether you contemplate changing your approach in view of the announcement of the Securities and Exchange Commission in connection with this same subject.

If you could have one of your staff call Charlie McManus or Don Chamblee of our Congressional staff, I would appreciate it.

Best regards,

Mike

C. M. Butler III
Chairman

P.S. We will be of service in any way we can. Generally, I concur in John Shad's approach to the problem. That Utility investors are adequately protected under the '33 and '34 Acts, and I expect our rate jurisdiction is adequate to protect consumers.

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TOM CORCORAN
19th District, Illinois

ENERGY AND COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
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December 23, 1981

James B. Edwards
Secretary
Department of Energy
Washington, D.C. 20585

Dear Mr. Secretary:

I understand that you have created a task force on the problems of the electric utility industry. The financial stability and solvency of the utility industry is vital to the success of President Reagan's economic recovery program, and I commend you for creating this task force.

As part of your review of the financial problems faced by utilities across the country, I urge you to study whether repeal or modification of the Public Utility Holding Company Act of 1935 would be in the public interest and interest of consumers and investors in order to improve the financial stability and health of the utility industry. Leaders of the industry and state and federal utility regulators are calling for amendments or repeal of the Act as a means of injecting the possibility of diversification and competition into the industry. Several bills have been introduced in both Houses of Congress to amend the Act, including the "Public Utility Financial Reform Act," H.R. 5220, which I introduced on December 15. I have enclosed information relating to H.R. 5220.

In particular, I recommend you study the following issues concerning the Public Utility Holding Company Act and electricity deregulation:

1. The extent to which the abuses and problems which led to enactment of the Public Utility Holding Company Act, including combination, cross-subsidization, and anti-competitive practices, have been resolved under the Act and are not likely to recur, with or without continued existence of the Act;

2. Whether regulation of registered utility holding companies under the Public Utility Holding Company Act duplicates existing federal, state or local regulation and constitutes a barrier to improved financial stability of such holding companies and their subsidiaries through diversification,

3. Whether regulation of exempt utility holding companies under the Public Utility Holding Company Act duplicates existing federal, state or local regulation and constitutes a barrier to improved financial stability of such holding companies and their subsidiaries through diversification;

4. In the absence of all or part of the Public Utility Holding Company Act, whether state and local authority to regulate utility holding companies and their subsidiaries would be adequate and sufficient to control the abuses and problems which led to enactment of the Act,

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5. The feasibility, from a regulatory, economic, and technological standpoint, of separately owned and operated facilities for the generation, transmission, and distribution of electric energy;

6. The feasibility of separately owned and operated facilities for electric energy and natural gas distribution;

7. Means of eliminating territorial and contractual restrictions on sales of electric energy to distributors of large industrial customers;

8. Means of reducing or eliminating legal and regulatory restrictions on entry into the business of the generation or transmission of electric energy, and

9. The feasibility, from a regulatory, economic, and technological standpoint, of jointly owned facilities for the generation or transmission of electric energy.

Although I understand the electric utility task force includes only members of the Department of Energy, I urge you to seek the counsel and advice of representatives outside the Department on this important issue. For example, I recommend you consult extensively with representatives of state public utility commissions, investor-owned and public-owned utilities, registered and exempt utility holding companies, electric cooperatives, industrial consumers of electricity and gas, members of the financial community, the general public, and relevant Federal agencies with jurisdiction over the issues raised by the Act, such as the Securities Exchange Commission, Federal Trade Commission and Federal Energy Regulatory Commission. I believe a broad representation of views will assure in-depth consideration of the opportunities and costs of electric utility diversification and deregulation.

As you know, the House Energy Conservation and Power Subcommittee, of which I am a member, has been conducting hearings on issues facing the electric utility industry. I am hopeful that Chairman Ottinger will review the Public Utility Holding Company Act in hearings early next year. In advance of such hearings, I would be pleased to meet with you and the members of your electric utility task force at your convenience to discuss our mutual reviews of the Act.

Please give me a call if you have any questions or suggestions, or have your staff contact Al Cobb of my personal staff at 225-9106. I look forward to working with you on this issue.

Thank you for your consideration of this request.

Sincerely,

Tom Corcoran

Tom Corcoran
Member, Subcommittee on Energy
Conservation and Power

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THE SECRETARY OF ENERGY
WASHINGTON, D.C.

January 15, 1982

Honorable Tom Corcoran
House of Representatives
Washington, D.C. 20515

Dear Tom:

Thank you for your letter of December 23, 1981, noting the internal task force I created within the Department to address electric utility issues.

I couldn't agree more with your perspective that revitalizing the electricity sector will be instrumental to strengthening our Nation's economy. Moreover, this task force will indeed address the issues raised by the Public Utility Holding Company Act of 1935. The flexibility of utilities to diversify their business activities could be an important part of the remedy to their serious financial problems.

You expressed your concern that a task force limited to the Department of Energy (DOE) personnel would not benefit from the perspectives of the utility managers, State regulatory officials and others who really control the destiny of this industry. Again, I fully agree; the internal task force is simply a means of coordinating DOE participation in a larger project designed to incorporate the key decisionmakers you identify. Our intent with this larger project is to serve as a facilitator among the various players in seeking resolution of the many difficult issues facing this industry. Only through such a process of consensus building is there any hope of breaking down the many barriers to economic efficiency which are plaguing electric power.

Your leadership in reforming the Public Utility Holding Company Act is consistent with our objectives of attacking barriers to efficiency in the electric utility industry. The ideas expressed in your letter will be integrated into our thinking as we select issues to be addressed in our electric utility project. I look forward to working with you on electric power matters in the future.

Sincerely,

James B. Edwards

James B. Edwards

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Department of Energy
Washington, D.C. 20585

June 14, 1982

Honorable Alfonse M. D'Amato
Chairman, Subcommittee on Securities
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On June 8 and 10, 1982, the Securities Subcommittee held hearings on S. 1869, S. 1870, S. 1871, and S. 1977, bills to amend or repeal the Public Utility Holding Company Act of 1935.

A statement for the record which presents the Administration's views on the proposed bills is enclosed for your consideration.

The Office of Management and Budget has advised that the views expressed herein are in accord with the program of the President.

Sincerely,

Robert C. Odle, Jr.
Assistant Secretary for
Congressional, Intergovernmental
and Public Affairs

Enclosure

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STATEMENT OF

J. HUNTER CHILES, III

DIRECTOR, POLICY, PLANNING AND ANALYSIS

U. S. DEPARTMENT OF ENERGY

Mr. Chairman, Members of the Subcommittee:

I am J. Hunter Chiles, III, Director, Office of Policy, Planning and Analysis, Department of Energy. I appreciate the opportunity to appear before you today to present the views of the Administration on the Public Utility Holding Company Act of 1935 (hereinafter the 1935 Act). The Administration views the 1935 Act as another regulatory mechanism from a bygone era that has served its purpose. Today, it does nothing more than create a regulatory burden for the electric and gas utility industry from which little or no benefits are gained. As a result, the Administration supports S. 1977, which would repeal the 1935 Act. The Administration does not support the three bills, S. 1869, S. 1870, and S. 1971, either individually or collectively, which would modify the 1935 Act so substantially that the end result would be tantamount to repeal but would leave the Securities and Exchange Commission (SEC) with the chimera of regulatory authority. I would like to state the reasons for the Administration's position succinctly and leave with the Subcommittee an attachment to my statement which provides more detail.

Administration Position

The Administration's position is founded upon the following premises:

1. The industry environment justifying the 1935 Act is no longer present. The 1935 Act was enacted in an era of wildly speculative

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business schemes and massive securities frauds. The entire economy was in the throes of such schemes, not only public utilities. Many acts were passed to safeguard investors; the 1935 Act was only one of them.

2. Present laws duplicate much of the 1935 Act, making it redundant, and adding needlessly to the regulatory burden of the electric and gas utility industries. The SEC relies upon other laws, namely, the securities acts of 1933 and 1934, and not the 1935 Act, to regulate securities transactions and protect investors. The accounting standards required by the 1935 Act have become virtually universal, required by the SEC under its other statutory authority, by the Federal Energy Regulatory Commission (FERC), by the state regulatory commissions, and by the accounting profession. Intercompany transactions, now regulated by the 1935 Act, are or can be regulated by FERC and by state regulatory commissions. Corporate acquisitions, now regulated by the 1935 Act, are covered by the antitrust laws, and enforced by the Department of Justice, the Federal Trade Commission, and through private suits. The only activity covered by the 1935 Act and not covered elsewhere are the corporate and geographic simplification provisions. But here again the 1935 Act has served its purpose. The 216 holding companies registered with the SEC since 1935 have undergone SEC scrutiny so that today only 12 active registered systems remain. The SEC has not held a simplification proceeding for at least 20 years. The industry complexity justifying this form of regulation has disappeared.

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3. The 1935 Act intrudes into management decisionmaking and restricts the flexibility of management to develop corporate strategies that maximize the efficiency and welfare of the company, its ratepayers, and its investors. The 1935 Act requires companies to file for approval for a myriad of intra- and intercompany transactions that normally are the province of management without second guessing by the government.

4. The 1935 Act is an obstacle to diversification efforts by registered holding companies and exempt companies. The language of the statute prevents registered companies from acquiring functionally unrelated businesses. The ability of the SEC to revoke exemptions from registration has a chilling effect upon exempt companies in their diversification pursuits. The fear of coming under the registration requirements of the 1935 Act has stopped industrial entrants into some parts of the electric power industry.

While the Administration supports repeal of the 1935 Act because it is a regulatory anachronism and burden, the issue that is engendering the most concern is utility diversification. Consumers and state regulatory commissions worry that a holding company embarking upon a diversification strategy will affect the utility operating company in a host of adverse ways, including draining utility assets, diverting management attention and skills, making bad investments that have a negative impact on the operating company, and generally bleeding the utility to the detriment of ratepayers but to the benefit of stockholders. Others have voiced the concern that diversification by utilities into nonutility

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businesses can be inefficient and anticompetitive, that is, it is a method of evading rate regulation by charging excessive intercompany transfer prices between the regulated and nonregulated companies. These concerns may be legitimate. But the 1935 Act is not the vehicle to deal with these concerns. It is poorly designed to deal with them and may be creating an illusion that protection exists at the federal level when there is no real protection.

Without taking a position on the benefits or detriments of diversification of a particular utility into nonutility businesses, the Administration believes that there are better ways to deal with the issue than through the retention of the 1935 Act. The states are grappling with the utility diversification issue at the moment. That is where the issue should generally be dealt with, at the state level where the resources of the state commission can be focused to deal with the unique situations posed by each company. A broad brush federal statute such as the 1935 Act does not allow for the careful formulation of rules to deal with the individuality of companies. Moreover, the 1935 Act does not preempt state efforts. States are now free to enact legislation or promulgate rules concerning diversification and several have done so or are considering such steps. Finally, the 1935 Act's applicability to diversification is very limited. Its strictures concerning acquisitions of functionally related businesses cover only twelve holding companies. While over 80 exempt companies are in the precarious position that exemptions may be revoked, the 1935 Act apparently has not held back those companies desiring to diversify. This leaves the federal

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regulatory scheme confused and discriminatory. It provides very limited protection to consumers and the states.

The Administration supports repeal of the 1935 Act and believes the issue of diversification should be addressed outside the scope of the current regulatory scheme. This does not preclude efforts by any state to address the diversification issue. In this regard, the Administration would insert into any legislation that repeals the 1935 Act a provision which stays the effective date of the legislation for two years to give the states time to consider whether any additional legislation is required.

Conclusion

The Administration strongly supports the repeal of the 1935 Act. Its justification is no longer applicable in today's environment. It is redundant and burdensome to the utility industry. It limits management flexibility and efficiency. It hinders diversification. Its benefits appear minimal compared to its regulatory costs.

This concludes my oral statement. I am available for any questions that you may have.

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Attachment to DOE Statement

This Attachment provides some more detail supporting the Administration's position.

The 1935 Act

The 1935 Act is a regulatory statute in addition to being a disclosure statute. It is aimed at financial transactions, corporate structures, acquisitions and dispositions of assets, and potential conflicts of interest.

The 1935 Act requires that all holding companies with subsidiaries engaged in any aspect of the electric utility business or in the retail distribution of natural gas register with the SEC. Twelve holding companies fall within this registration provision. Nine are electric utility systems and three are gas utility systems. In 1981, gross revenue terms, the nine electrics represent about 20 percent of the investor-owned electric utilities, and the three gas companies represent about 8 percent of the gas utility industry.

Once a holding company registers, it becomes subject to two principal kinds of regulation: the geographical integration and corporate simplification process, and the various regulations concerning financial and operational aspects of the holding company system, including transactions

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with affiliated entities. The integration and simplification process of section 11 provides a method for the SEC to examine the corporate structure of each registered holding company. During this examination, the SEC must determine the extent to which the structure should be simplified, e. g., eliminate pyramid holding companies, and the business geographically integrated, e. g., eliminate companies that are not geographically contiguous. The integration process was designed to limit the operations of the company to a single integrated electric or gas utility system with only "such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of [the] . . . system." Integrated operations are specifically defined in the statute as a means of providing guidance to the SEC in its determinations (See section 2 of the 1935 Act.)

Section 11 of the 1935 Act permits a registered holding company to retain any nonutility business only if it is "reasonably incidental, or economically necessary or appropriate to the operations" of the utility system based upon a public interest standard. Through court interpretations of the statutory language, this has become known as the "functionally related" test for nonutility acquisitions.

Once the registered holding company has been simplified, it must comply with the many other provisions which include review of securities issuances, proxy solicitations, accounting practices, intrasystem transactions including intercompany loans, dividends, capital contributions, acquisitions by companies of their own securities, service company

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operations and services rendered by affiliates, and sales and acquisitions by holding companies of utility assets or of securities of utility companies.

While only 12 companies presently are registered under the 1935 Act, about 80 companies are exempt from the 1935 Act. These companies primarily are intrastate operations. A company that meets the exemption criteria is exempt "unless and except insofar as [the Commission] finds the exemption detrimental to the public interest or the interest of investors or consumers." This is the so-called "unless and except" clause, which gives the SEC the power to revoke the exemption. While the SEC has not revoked the exemption of any company in recent memory, it came close to imposing a series of restrictive guidelines on the types of investments that an exempt company could make. The threat of future SEC action creates a chilling atmosphere on the management prerogatives of the exempts.

The Industry Environment Justifying the 1935 Act No Longer Exists

The 1935 Act was passed in an era of wild speculation that pervaded the entire economy and not only the utility sector. The growth of the utility sector during the 1920s was phenomenal, generating skyrocketing profits. The boom mentality which pervaded the 1920s combined with an almost insatiable demand by small investors for anything labeled "utility stock" created a classic speculative bubble. This bubble burst with the onset of the depression leaving a number of holding companies in bankruptcy.

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The speculation of the 1920s occurred in an environment of very limited state and federal regulation of utilities. The SEC was not formed until 1933. As late as 1935, there were only 22 states that regulated electric utility rates, while more states regulated entry. The legislation establishing the 1935 Act also introduced regulation of interstate electricity sales. Therefore, with little regulation on either the state or federal level, a public willing and eager to invest, and a rapidly expanding industry with great mystique, the stage was set for the type of abuses that occurred.

Holding companies, while initially serving a useful purpose by giving local utilities access to national capital markets, soon became vehicles for abuses. Stock was watered and companies were pyramided so that by 1929 the aggregated value of utility holding company securities was estimated at $19 billion which represented an investment of no more than $3 billion in capital plant and equipment. The difference between the two sums went to line the pockets of bankers, speculators, and corporate insiders.

There is a well documented history of abuses that led to the passage of the 1935 Act. It is clear, however, that the abuses prevalent in the 1920s do not exist today. As a result, it is appropriate to examine the 1935 Act to determine whether it is still necessary.

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The 1935 Act Is Redundant and Burdensome

The environment in which the utility industry operates today is vastly different from the go-go days of the 1920s. The industry is encumbered with layer upon layer of state and federal regulation that makes it impossible for the industry to repeat the abuses of the 1920s. The level of market sophistication is such that the pervasive schemes rampant in the 1920s would fall on deaf ears today. The many institutional structures, other than the 1935 Act, are sufficient to protect consumers, ratepayers, and investors.

At the federal level, there are the following laws that regulate and protect:

- Securities Act of 1933 and Securities Exchange Act of 1934: The SEC relies upon these Acts and their amendments as its authority for regulation of all companies concerning securities disclosure, accounting standards, affiliate transactions and other securities practices. The 1933 and 1934 Acts provide extensive protection for investors through detailed disclosure requirements and vigorous SEC enforcement. The SEC has used its authority under these Acts to require accounting standards for the form and content of financial statements.

- Federal Power Act: This Act gives the FERC the power to approve securities issuances to the extent not regulated by states. The Federal Power Act also authorizes standard accounting practices.

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Affiliate transactions are covered by various provisions of the Federal Power Act and the 1933 and 1934 Acts. FERC's authority to set wholesale rates gives it the ability to examine the amounts paid to affiliates and to disallow expenses that are unreasonable. The disclosure requirements of the 1933 and 1934 Acts, plus the accounting standards established since 1935, combine to inhibit the recording of such transactions other than honestly and fairly.

- Antitrust laws: The antitrust laws are available to protect against the 1935 Act's strictures against undue concentration of control. The Department of Justice recently has indicated its concern over various forms of acquisitions that lead to inefficient and anti-competitive results in the electric power and natural gas utility industries. The antitrust laws are more than adequate to cope with such situations on a case-by-case basis.

- Federal Election Campaign Act and Federal Regulation of Lobbying Act: These laws protect the public in the same manner that the 1935 Act does.

At the state level, each state has a regulatory commission that regulates electric and gas utilities. For example, all states regulate retail rates. Forty-five states specifically require state regulatory commission approval prior to the issuance of securities. Most require uniform accounting standards. Over forty deal with intercompany transactions in some manner.

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Finally, unsound financial transactions are much more difficult to perpetrate in today's marketplace. There are many actors in the financial marketplace that place great regard for their reputations upon their financial evaluations. Investment bankers derive much of their business from reputation. The same is true of financial analysts and rating services. Poor evaluation and hiding of unsound financial practices would affect their reputations adversely and the confidence of institutional and individual investors would diminish. Thus, the general level of investor sophistication requires that careful analysis be given to the financial evaluations performed by bankers, analysts, and rating services.

Management Decisionmaking

Various parts of the 1935 Act inject the SEC into the decisionmaking process of utility management. This detracts from the ability of the management to deal efficiently or flexibly with its internal strategic planning. The subjects which come under the 1935 Act's purview include: intercompany loans, indemnification of or lending of credit among companies, dividends, sale of outstanding securities and assets, proxies, and service, sales, and construction contracts.

Only the 12 companies registered under the 1935 Act have to comply with these provisions. The approval process is costly in terms of time and money. It usually takes at least 60 days to obtain a determination from the SEC on these various transactions. In the interim, circumstances

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can change sufficiently for the transaction to fall through, impairing the company substantially.

Other requirements imposed under the Act may adversely affect utility financing. For example, requiring marketing of securities through competitive bids, prevent negotiated sales, which may benefit the utility more than competitive sales of securities. There also are restrictions concerning first mortgage bonds that may make financing more costly. There is no doubt that the flexibility of management is hindered by various provisions of the 1935 Act that either are redundant or burdensome without any justification.

Utility Diversification

Without taking a position on the attributes or detriments of diversification of a particular utility into nonutility businesses, we believe the issue of diversification should be addressed outside the scope of the current regulatory scheme. It is clear that now utilities have differing abilities to diversify. Registered companies are the most restricted. Exempt companies diversify at their peril with the sword of Damocles hanging over their corporate heads in the form of potential SEC revocation of their exemption. Nonutility companies fear that entry into aspects of the utility business may expose them to registration under the 1935 Act. For example, a company desiring to enter into electric power generation may find itself subject to the 1935 Act depending upon the interpretation given the 1935 Act by the SEC.

Additionally, the states are grappling with the utility diversification issue at the moment. While each state may want to regulate in different ways, they can do so now even with the 1935 Act in place, and several have done so. The 1935 Act is only very limited protection to the states.

In this regard, any legislation that repeals the 1935 Act ought to include a provision which stays the effective date of the legislation for two years to give the states the time to consider whether any additional legislation is required.

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TESTIMONY OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL

ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before this Subcommittee to present the views of the Department of Justice on the issue of repeal or amendment of the Public Utility Holding Company Act ("Act"). A central feature of the Act is the requirement that certain electric and gas utility holding companies must obtain the prior approval of the Securities and Exchange Commission ("SEC") before making significant acquisitions. In such cases, the Department may and, on occasion, has elected to raise its concerns about the likely competitive effects of proposed acquisitions before the SEC. Accordingly, and because of our concerns about the competitive implications of utility diversification generally, the Department has a direct interest in any bill that might affect the present statutory scheme.

The Department also plays a role in formulating proposals to implement this Administration's frequently expressed commitment to removal of regulatory burdens on private enterprise whenever possible. The Department's approach to deregulation here, as in other contexts, is based on the premise that economic regulation is, at best, a poor substitute for competition and should be employed only in those relatively few situations where it yields a net improvement over the performance of the market and that improvement outweighs regulation's costs.

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In this spirit we have examined S. 1869, S. 1870, S. 1871 and S. 1977, bills which would amend or repeal the Act in the following ways:

- S. 1869 would make selective, substantive changes in the Act to reduce SEC oversight to allow diversification into non-utility business interests without SEC approval for registered electric holding companies.

- S. I870 would allow exempt companies to form exempt holding companies and would remove the SEC's discretionary authority to deny that exemption if a company diversifies.

- S. 1871 would exempt from coverage the three gas utilities now regulated under the Act.

- S. 1977 would repeal the Act in its entirety.

The Department of Justice supports S. 1977 and opposes those bills that fall short of complete repeal of the Act.

Although the Administration takes no position on the desirability of any particular utility diversification, we do want to note Justice Department concern about the competitive implications of utility diversification. Because of that general concern, we believe that partial repeal, designed

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explicitly or implicitly to permit and endorse diversification while leaving the Act's remaining regulatory features intact, would not be well-advised. We believe that complete repeal is less likely to be viewed as a signal encouraging diversification, and we agree with the SEC's judgment that the Act's regulatory panoply is unnecessary to serve its original purposes of protecting investors.

The SEC has expressed support for a wholesale repeal of the Act. It has concluded that new accounting methods and reporting requirements embodied in other statutes -- especially the securities laws it administers -- make the recurrence of significant abuses that would injure investors unlikely. Moreover, the Act has narrow coverage and is not applicable to the majority of utilities. Given this assessment, we share SEC's view that continued regulation cannot be justified.

Our examination of the costs and benefits of the present statutory scheme has focused primarily on the aspect of SEC regulation of most concern to the Department -- the SEC's interpretation that the Act permits registered holding companies to diversify, but only into functionally-related areas. */ For example, under this interpretation, the SEC

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*/ See Michigan Consolidated Gas Co. v. Securities & Exchange Commission, 444 F.2d 913 (D.C. Cir. 1971).

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would more thai likely allow an electric utility holding company to integrate upstream into its fuel supply, but disallow its acquisition of a chain of drug stores. Although we do not doubt that this line of interpretation correctly furthers the purposes of shareholder protection that the SEC is pursuing, unfortunately, this approach heightens -- rather than lessens -- our competitive concerns about diversification, because diversification into related areas is more likely to create the potential for cross-subsidization that goes undetected than is diversification into remote areas of activity.

We recognize that the financial health of the electric and gas utility industries is vital to this country's economic and social well being. Many utilities, deeply concerned about their long-term financial health, see some salvation in diversification into unregulated markets, pointing to evidence that past diversifications by utilities have, on balance, improved the financial performance of the overall firm. We are sympathetic to utilities' financial concerns and recognize the institutional difficulties that lie in the way of direct solutions. Allowed rates of return may, in many cases, be held too low by state regulation. As a consequence, many utilities are widely considered to be in poor financial condition.

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Diversification, however, does not address this fundamental regulatory problem. It attempts to ameliorate it, but in doing so, may only compound it. Diversification by a regulated utility to reduce risks should be unnecessary, since rate-of-return regulation, when done properly, should compensate adequately for risks undertaken. Moreover, absent opportunities to engage in collusive or monopolistic behavior, the best a utility can hope for by diversifying into an unregulated market is a competitive rate of return. Presumably, these returns are essential to the continued success of the new, competitive venture. If properly treated by regulators, such success should not significantly affect the regulated divisions of the companies. But it is also true that diversification, if properly handled by regulators, will not be able to offset the low rates of return associated with the regulated entity. Diversification cannot succeed in solving a problem that ought to be dealt with directly -- an inability, whether actual or perceived, to earn a fair rate of return under regulation.

There is also a possibility, however, that diversification may further damage the utility's financial condition by prompting the regulator to extend regulation, directly or indirectly, over unregulated assets and activities and use them to subsidize the utility's rate payers. For example,

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as detailed in the Department's most recently published report on Competition in the Coal Industry, */ some state regulatory commissions have limited, in various ways, the price a utility may pay for coal purchased from its coal subsidiary to below the competitive level. This results in the inefficient subsidization of utility ratepayers at the expense of the utility and its investors.

The particular concern of the Justice Department, however, centers on the policy questions involved whenever a regulated enterprise seeks to enter an unregulated market. Such entry can be a device for circumventing rate regulation and may distort economic performance in the previously competitive market as well. To illustrate this concern, I will refer again to our recent Coal Report, in which we examined the question of regulating dealings between regulated electric utilities and their coal-producing affiliates or subsidiaries. The Report concluded that state and federal regulatory authorities are unable to cope with the complex task of regulating internal transfer prices for coal and that integration of electric utilities into coal markets is, therefore, likely to circumvent effective rate regulation. Because the regulator cannot know what a competitive, arm's-length coal transfer price would be, the utility has every

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*/ U.S. Department of Justice, Competition in the Coal Industry 57-58 (March 1982).

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incentive to inflate the price it pays its subsidiary, passing on to utility ratepayers any excess costs and artificially enhancing the profitability of the coal subsidiary.

The Department's concern about regulatory evasion through utility diversification is not limited to the sort of transfer pricing problems that arise when the diversification is in a vertically related activity. Even non-vertically related diversification may raise issues of joint cost allocation between regulated and unregulated sectors, issues which may transcend the ability of regulators to recognize and deal with them.

For example, a decade of litigation against AT&T, involving many incidents where regulated and unregulated companies did business under common control, has ended with a settlement proposing corporate realignments and divestiture to an unprecedented degree. The consistent underlying theme of that settlement is a painstaking effort to separate the unregulated sections of the company from those that are regulated in order to prevent the competitive problems that occurred by reason of that common control. This will free what can be freed of AT&T to competitive forces and, by setting up independent companies, minimize the task of regulating those natural monopoly aspects of telecommunications service that must continue to be regulated.

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Nevertheless, we recognize that the Public Utilities Holding Company Act has not proved an effective instrument for dealing with our concerns about diversification. As interpreted, it permits precisely those forms of diversification we find most troublesome. From the Department's perspective, the Act is not well-suited to advance antitrust enforcement policy in the regulatory context. We are prepared to deal with any increase in merger activity by regulated firms by evaluating the merits of acquisitions on a case-by-case basis under the antitrust laws. Given that the SEC is satisfied that it can adequately regulate the securities dealings of utility holding companies under other federal statutes, the Department supports repeal of the Act in its entirety.

I thank the Subcommittee for this opportunity to explain our views on these issues. I would be happy to answer any questions.

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STATEMENT OF

WILLIAM H. GRIGG
EXECUTIVE VICE PRESIDENT
FINANCE AND ADMINISTRATION
DUKE POWER COMPANY

SUBCOMMITTEE ON SECURITIES
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
JUNE 10, 1982

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I VERY MUCH APPRECIATE THE OPPORTUNITY TO TESTIFY BEFORE YOU TODAY ON THIS IMPORTANT ISSUE AFFECTING OUR NATION'S ELECTRIC AND GAS UTILITIES. MY NAME IS WILLIAM H. GRIGG, AND I AM EXECUTIVE VICE PRESIDENT FOR FINANCE AND ADMINISTRATION OF DUKE POWER COMPANY, AN INDEPENDENT OPERATING COMPANY PROVIDING ELECTRIC SERVICE IN THE CENTRAL PORTION OF NORTH CAROLINA AND THE WESTERN PORTION OF SOUTH CAROLINA. AS SUCH, I AM RESPONSIBLE FOR ALL OF THE NON-REGULATED ACTIVITIES OF DUKE POWER'S CORPORATE SUBSIDIARIES. DUKE POWER COMPANY IS THE NINTH LARGEST INVESTOR-OWNED UTILITY IN THE UNITED STATES IN TERMS OF KILOWATT-HOUR SALES AND IS NOT NOW SUBJECT TO THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935. I AM ALSO REPRESENTING AN AD HOC GROUP OF JUST UNDER 30 ELECTRIC, COMBINATION GAS AND ELECTRIC, AND GAS UTILITIES THAT HAVE AN INTEREST IN THE HOLDING COMPANY ACT. SOME OF THESE COMPANIES ARE PRESENTLY EXEMPT HOLDING COMPANIES UNDER THE ACT, WHILE

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OTHERS, LIKE DUKE, ARE NOT NOW SUBJECT TO THE ACT BUT ARE CONSIDERING ACTIVITIES THAT COULD SUBJECT THEM TO THE ACT OR THAT COULD BE AFFECTED BY REFORM OF THE ACT.

MR. CHAIRMAN, WE AGREE WITH MUCH OF THE TESTIMONY THAT HAS PREVIOUSLY BEEN PRESENTED TO THIS DISTINGUISHED SUBCOMMITTEE, THE BASIC THRUST OF WHICH IS THAT THE HOLDING COMPANY ACT NO LONGER SERVES ANY USEFUL PURPOSE. WE ALSO WANT TO STRESS OUR BELIEF THAT THE ACT NOW IMPOSES UNNECESSARY AND, IN SOME CASES, WHOLLY UNINTENDED REGULATORY BURDENS ON A FINANCIALLY PRESSED INDUSTRY. AT THE PRESENT TIME, THESE REGULATORY BURDENS ARE ACTUALLY WORKING AGAINST THE BEST INTERESTS OF INVESTORS AND CONSUMERS. SINCE THIS FACT HAS BEEN RECOGNIZED BY BOTH THE SECURITIES AND EXCHANGE COMMISSION (SEC) AND THE ELECTRIC AND GAS UTILITY INDUSTRY, IT SHOULD BE A SIGNIFICANT SIGNAL TO CONGRESS THAT THE SUBJECT IS RIPE FOR ACTION.

BY ALMOST ANY FINANCIAL MEASURE, THE ELECTRIC UTILITY INDUSTRY IS EXPERIENCING SERIOUS FINANCIAL DIFFICULTIES. THIS IS DUE, IN LARGE PART, TO THE FACT THAT THE BASIC ECONOMIES OF THE INDUSTRY CHANGED SOME 15 YEARS AGO, AND IT IS NO LONGER, AS IT ONCE WAS, A DECREASING COST INDUSTRY. IN PREVIOUS TESTIMONY BEFORE THIS SUBCOMMITTEE, MR. CHARLES BENORE, SENIOR VICE PRESIDENT OF THE INVESTMENT BANKING FIRM OF PAINE WEBER MITCHELL HUTCHINS, CHARACTERIZED THE FINANCIAL INTEGR-

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ITY OF THE INDUSTRY AS "AT A LOW, NEAR DANGEROUS LEVEL", WHILE CONGRESSMAN CORCORAN WARNED OF THE "DEVASTATING IMPACT ON THE NATION'S ECONOMY" IF THE INDUSTRY'S FINANCIAL DIFFICULTIES WERE ALLOWED TO CONTINUE.

DESPITE SOME RECENT IMPROVEMENT, THE COMMON STOCKS OF MOST UTILITIES ARE STILL SELLING WELL BELOW THEIR BOOK VALUES AS COMPARED TO THE INDUSTRY AVERAGE OF 250% OF BOOK VALUE AS RECENTLY AS THE 1960s. THE REASONS FOR THIS DECLINE ARE QUITE SIMPLE. AS THE COMMITTEE ON ENERGY OF THE ASPEN INSTITUTE POINTED OUT, "DIVIDENDS TO STOCKHOLDERS, WHICH WERE FORMERLY A MAJOR ATTRACTION FOR [UTILITY] INVESTORS, HAVE DECLINED . . . IN REAL TERMS. THE AVERAGE YIELD . . . WHEN ADJUSTED FOR STOCK PRICE DECLINES, IS WELL BELOW THE AVERAGE TOTAL INVESTOR RETURNS FROM INDUSTRIAL STOCKS OR OTHER COMPETITIVE INVESTMENTS." AS A RESULT, UTILITIES HAVE FOUND IT INCREASINGLY DIFFICULT TO ATTRACT EQUITY CAPITAL. IN FACT, PACIFIC GAS & ELECTRIC COMPANY AND THE INDIVIDUAL COMMISSIONERS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION HAVE RECENTLY BEEN SUED BY A STOCKHOLDER OF THE COMPANY FOR CAUSING NEW COMMON STOCK TO BE ISSUED TO THE PUBLIC AT A PRICE BELOW BOOK VALUE.

SIMILAR DIFFICULTIES HAVE CONFRONTED UTILITIES WITH RESPECT TO THEIR DEBT SECURITIES. UTILITY BOND RATINGS HAVE

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BEEN FALLING, REFLECTING THE INVESTMENT COMMUNITY'S BELIEF THAT THE INDUSTRY'S ABILITY TO SERVICE ITS DEBT HAS BEEN DECLINING. FOR EXAMPLE, ACCORDING TO STANDARD & POOR'S, IN 1970, 8% OF ELECTRIC UTILITY BONDS HAD THE HIGHEST RATING, AAA, WHILE ONLY 4% HAD THE LOWEST "INVESTMENT GRADE" RATING, BBB. BY NOVEMBER 1981, 32% OF SUCH BONDS WERE RATED BBB WHILE ONLY 2% WERE RATED AAA. THIS DETERIORATION IS ALSO EVIDENCED BY THE FACT THAT IN 1980, 28 UTILITIES HAD THEIR BOND RATINGS LOWERED WHILE ONLY THREE HAD THEM RAISED. AS YOU KNOW, LOWERED BOND RATINGS RESULT IN HIGHER INTEREST CHARGES THAT ARE ULTIMATELY REFLECTED IN CUSTOMER BILLS.

THE DRAMATIC DECLINE IN THE FINANCIAL CONDITION OF THE UTILITY INDUSTRY HAS HAD VERY UNFORTUNATE EFFECTS ON BOTH INVESTORS AND CONSUMERS. IN HIS RECENT TESTIMONY BEFORE A COMMITTEE OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC), MR. JOHN W. BARR OF MORGAN STANLEY & CO. INCORPORATED SUGGESTED THE FOLLOWING:

> THE INVESTORS--BOTH INSTITUTIONAL AND INDIVIDUAL--IN UTILITY SECURITIES HAVE SUFFERED HUNDREDS OF MILLIONS OF DOLLARS OF LOSSES IN THE MARKET VALUE OF THEIR SECURITIES, BOTH DEBT AND EQUITY, RESULTING FROM REPEATED DOWNGRADINGS OF DEBT SECURITIES AND INADEQUATE EARNED RETURNS ON THEIR EQUITY INVESTMENTS. THEY WOULD HARDLY AGREE THAT THEY HAVE AVOIDED RISK BY BUYING UTILITY SECURITIES. ALTHOUGH SUCH SECURITIES WERE ONCE VIEWED AS A "SAFE HAVEN" BY INVESTORS, THEY ARE NOW VIEWED WITH CAUTION BECAUSE THEY INVOLVE A KIND OF DOUBLE JEOPARDY: PRESENT ARE THE NORMAL

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> BUSINESS RISKS FOUND IN OTHER INDUSTRIES, BUT OVERLAID ARE . . . REGULATORY AND JUDICIAL RISKS . . . INVESTORS HAVE COME TO REALIZE THAT UTILITIES ARE NOT BENEFICIARIES OF THE NATURAL MONOPOLIES IN WHICH THEY OPERATE. INSTEAD UTILITIES HAVE SUFFERED THE PENALTIES OF A MONOPOLY: THEY HAVE BEEN FORCED BY THEIR OBLIGATION TO SERVE CUSTOMERS TO ADD ASSETS TO THEIR RATE BASE WHICH EARN SUBSTANTIALLY LESS THAN THE COST OF FINANCING THOSE ASSETS. FOR A NONREGULATED COMPANY THE CAPITAL BUDGETING DECISION IS EASY TO MAKE WHEN THE "HURDLE" RATE IS NOT MET. BUT UTILITIES ARE NOT FREE TO MAKE THIS DECISION.

I WOULD LIKE TO SHARE WITH THE SUBCOMMITTEE SOME OF THE RISKS THAT THE INVESTMENT COMMUNITY CURRENTLY ASSOCIATES WITH THE UTILITY INDUSTRY. FIRST OF ALL, THERE IS THE FUNDAMENTAL FINANCIAL RISK FOUND IN AN INDUSTRY WHERE CREDIT RATINGS HAVE BEEN DETERIORATING, INTEREST COVERAGES HAVE BEEN DECLINING AND REGULAR ACCESS TO THE CAPITAL MARKETS IS IN JEOPARDY. SECONDLY, THERE IS THE RISK THAT DUE TO INFLATION, RISING FUEL COSTS AND THE GENERAL REGULATORY ENVIRONMENT, UTILITIES WILL CONTINUE TO BE FORCED TO DELAY OR CANCEL CONSTRUCTION OF NEEDED FACILITIES, WITH INVESTORS BEARING ALL OR PART OF THE COST OF SUCH DELAYS OR CANCELLATIONS. THIRDLY, IN THE EYES OF INVESTORS, THERE ARE REGULATORY AND JUDICIAL RISKS THAT AFFECT ALL ASPECTS OF THE BUSINESS. ACCORDING TO PAINE WEBBER MITCHELL HUTCHINS, THE RISK OF UTILITY STOCKS, MEASURED AS A STANDARD DEVIATION OF RETURNS, HAS BEEN COMPARABLE TO THAT OF OTHER STOCKS, AND SURVEYS BY

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THE SAME FIRM INDICATE THAT MANY INVESTORS NOW CONSIDER INVESTMENTS IN UTILITY SECURITIES TO BE "RISKIER" THAN INVESTMENTS IN SECURITIES OF INDUSTRIAL COMPANIES. RETURNS MUST ACCURATELY REFLECT RISK IF THE UTILITY INDUSTRY IS TO CONTINUE TO ATTRACT NEEDED CAPITAL.

BECAUSE UTILITY RETURNS HAVE BEEN INADEQUATE, CAPITAL HAS BEEN FLEEING THE INDUSTRY FOR INVESTMENT OPPORTUNITIES THAT OFFER REWARDS THAT ARE COMMENSURATE WITH THE RISKS INVOLVED. AS A RESULT, UTILITIES HAVE BEEN EXPERIENCING HIGHER COSTS OF CAPITAL THAT ARE ULTIMATELY BILLED TO CONSUMERS THROUGH THE RATEMAKING PROCESS.

THE UTILITY INDUSTRY HAS BEEN ACTIVELY PURSUING A NUMBER OF ALTERNATIVE SOLUTIONS TO ITS FINANCIAL PROBLEMS. THESE INCLUDE: A) A REDUCTION OF CAPITAL REQUIREMENTS THROUGH MORE EFFICIENT USE OF EXISTING PLANT FACILITIES, LOAD MANAGEMENT TECHNIQUES, TIME-OF-DAY PRICING, DEVELOPMENT OF ALTERNATE ENERGY SOURCES AND ENERGY CONSERVATION EFFORTS; B) REFORM OF THE RATEMAKING PROCESS TO PROVIDE FOR ADEQUATE AND TIMELY RECOVERY OF OPERATING AND CAPITAL COSTS THROUGH, AMONG OTHERS, PROVISIONS FOR FORWARD-TEST PERIODS, MORE EFFECTIVE FUEL COST RECOVERY PROCEDURES, EXPEDITED GENERAL RATE PROCEEDINGS, ATTRITION ALLOWANCES TO OFFEST THE EFFECTS OF INFLATION, AND CONSTRUCTION WORK IN PROGRESS IN RATE

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BASE; AND C) HIGHER, MORE STABLE EARNINGS THROUGH SELECTIVE DIVERSIFICATION INTO COMPATIBLE, NON-REGULATED BUSINESS ACTIVITIES.

THE QUESTION OF DIVERSIFICATION HAS PARTICULAR RELEVANCE TO THESE PROCEEDINGS. IT IS A BUSINESS OPTION AND PRACTICE NORMAL TO MOST INDUSTRIES WHICH IS NOT AS A PRACTICAL MATTER SIMILARLY AVAILABLE TO UTILITIES. THIS IS DUE TO THE UNNECESSARY BARRIERS IMPOSED BY THE HOLDING COMPANY ACT.

SOME WHO HAVE TESTIFIED BEFORE THIS SUBCOMMITTEE HAVE SUGGESTED THAT EVEN IF, AS I BELIEVE IS THE CASE, THE HOLDING COMPANY ACT NO LONGER SERVES ANY USEFUL PURPOSE, THERE IS NO REAL HARM IN LEAVING THE ACT UNCHANGED. MR. CHAIRMAN, I RESPECTFULLY SUBMIT THAT IN VIEW OF THE DRAMATIC DETERIORATION OVER THE LAST 15 YEARS IN THE FINANCIAL CONDITION OF THE INDUSTRY, EVERY UNNECESSARY AND UNWARRANTED REGULATORY BURDEN MUST BE REMOVED IF THE UTILITY INDUSTRY IS TO CONTINUE TO PROVIDE THE SERVICE THAT THE CITIZENS AND INDUSTRY OF OUR NATION REQUIRE.

IN AN EARLIER HEARING BEFORE THIS SUBCOMMITTEE, OTHERS REFERRED TO THE LETTER, DATED DECEMBER 21, 1981, ADDRESSED TO YOU BY CHAIRMAN SHAD OF THE SEC, IN WHICH HE EXPRESSED THE UNANIMOUS POSITION OF THE SEC THAT THE

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HOLDING COMPANY ACT "HAS SERVED ITS BASIC PURPOSE AND THAT CONTINUED FEDERAL REGULATION OF UTILITY HOLDING COMPANIES IS UNNECESSARY AND INAPPROPRIATE." WE AGREE WHOLEHEARTEDLY WITH THIS STATEMENT BY THE SEC.

CHAIRMAN SHAD INDICATED IN THIS LETTER THAT THE "ABUSES"* THAT LED TO THE PASSAGE OF THE HOLDING COMPANY ACT "ARE UNLIKELY TO RECUR IN LIGHT OF THE EXTENSIVE CHANGES SINCE 1935 IN THE PUBLIC UTILITY AND INVESTMENT BANKING INDUSTRIES, THE ACCOUNTING PROFESSION, STATE UTILITY REGULATION, EXPANSION OF THE DISCLOSURE REQUIREMENTS UNDER THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, AND THE DEVELOPMENT OF MORE EFFICIENT AND WELL-INFORMED SECURITIES MARKETS." MR. CHAIRMAN, I WOULD LIKE TO ELABORATE ON SEVERAL OF THESE POINTS.

THE UTILITY INDUSTRY HAS CHANGED DRAMATICALLY SINCE 1935 WHEN THE HOLDING COMPANY ACT WAS PASSED TO REGULATE THE MANNER IN WHICH NATIONWIDE PUBLIC UTILITY HOLDING COMPANIES CONDUCTED AND FINANCED THEIR OPERATIONS.

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* IN 1928, THE UNITED STATES SENATE ORDERED THE FEDERAL TRADE COMMISSION (FTC) TO STUDY THE PUBLIC UTILITY INDUSTRY AND TO REPORT ITS FINDINGS TO THE SENATE. THE STUDY CULMINATED IN A NEWS RELEASE LISTING 19 "ABUSES AND EVIL CONDITONS" THAT LED TO PASSAGE OF THE ACT. THEY ARE ATTACHED AS ANNEX A HERETO.

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In 1938, for instance, there were 214 registered holding companies controlling 922 electric or gas utility subsidiaries. Pursuant to Section 11(b) of the Act, described variously in 1935 as the "heart of the Act" or the "death sentence", the SEC began a vigorous program of forced divestitures designed to break up such holding company systems by integrating utility operations and by spinning off geographically unconnected operations. This SEC mandated divestiture program employed nearly 250 people in the Division of Public Utilities (now the Division of Corporate Regulation) in the 1940s. Today, by contrast, there are only 14 registered holding companies, over 300 independent electric and gas utility operating companies, and fewer than 20 people on the staff of the Division of Corporate Regulation. Clearly, the Act has accomplished its major purpose.

One of the principal reasons given at the time for breaking up the registered holding company systems was a concern that state regulation of public utilities was in its early stages. According to a 1977 statement by the SEC concerning the Holding Company Act, "[A] major purpose of the Act was to make possible, rather than to displace, state regulation" of public utility holding companies. Section 11 contemplated the development of effective state regulation

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WHICH, IN FACT, HAS NOW TAKEN PLACE. THIS WAS TO BE FOLLOWED BY AN "EFFECTIVE SYSTEM OF ORDERLY DEREGULATION" WHEREBY FEDERAL CONTROL OVER UTILITY HOLDING COMPANIES WOULD BE REDUCED. AS THE SEC THEN SAID, "CONGRESS DID NOT INTEND THAT UTILITIES WOULD REMAIN PERMANENT FEDERAL WARDS UNDER THE ACT."

IT SHOULD BE CLEAR TODAY THAT REGULATION OF PUBLIC UTILITIES AT THE STATE LEVEL, ESPECIALLY WHEN CONSIDERED IN THE CONTEXT OF THE EXISTING OVERLAY OF OTHER FEDERAL LAWS RELATING SPECIFICALLY TO ELECTRIC AND GAS UTILITIES AS WELL AS TO MORE GENERAL FEDERAL LAWS SUCH AS THE SECURITIES AND ANTITRUST LAWS, IS MORE THAN ADEQUATE TO PROTECT THE PUBLIC INTEREST EVEN IF THE HOLDING COMPANY ACT WERE TO BE REPEALED. IN 1935, FOR EXAMPLE, THERE WERE ONLY 22 STATES THAT REGULATED THE RATES THAT UTILITIES WERE PERMITTED TO CHARGE THEIR CUSTOMERS. TODAY, VIRTUALLY EVERY STATE PUBLIC SERVICE COMMISSION, AS WELL AS THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) WITH RESPECT TO WHOLESALE RATES, ESTABLISHES SUCH RATES. ADDITIONALLY, VIRTUALLY ALL STATE PUBLIC SERVICE COMMISSIONS HAVE BROAD SUPERVISORY POWERS OVER PUBLIC UTILITIES SUBJECT TO THEIR JURISDICTION, INCLUDING THOSE OVER FRANCHISES AND THE ISSUANCES OF CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY. BROAD STATUTORY GRANTS OF

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AUTHORITY ARE OFTEN TIMES USED BY STATE PUBLIC SERVICE COMMISSIONS TO SUPPLEMENT SPECIFICALLY ENUMERATED STATUTORY POWERS.

CERTAIN OTHER AREAS OF STATE REGULATION OF PUBLIC UTILITIES WARRANT SPECIFIC MENTION BECAUSE OF THEIR RELEVANCY TO THE ISSUES PRESENTED IN THESE HEARINGS. FORTY-FIVE STATES, FOR EXAMPLE, SPECIFICALLY REQUIRE PRIOR APPROVAL BY A STATE PUBLIC SERVICE COMMISSION OF THE ISSUANCE OF SECURITIES BY A PUBLIC UTILITY. THE PURPOSES FOR WHICH SECURITIES MAY BE ISSUED BY PUBLIC UTILITIES ARE OFTEN LIMITED BY STATUTE TO THOSE RELATED TO THE UTILITY BUSINESS. SUCH STATUTES USUALLY MANDATE A STANDARD OF STATE PUBLIC SERVICE COMMISSION REVIEW OF PROPOSED SECURITY ISSUANCES DESIGNED TO PROTECT THE PUBLIC INTEREST. ADDITIONALLY, SECTION 204(A) OF THE FEDERAL POWER ACT AUTHORIZES FERC TO APPROVE THE ISSUANCE OF SECURITIES BY A PUBLIC UTILITY, OR AN ASSUMPTION OF LIABILITY WITH RESPECT TO THE SECURITIES OF ANOTHER PUBLIC UTILITY, UNLESS THE PUBLIC UTILITY IS ORGANIZED AND OPERATING IN A STATE UNDER THE LAWS OF WHICH ITS SECURITIES ISSUANCES ARE REGULATED. AS MR. SOLOMON FREEDMAN INDICATED IN HIS TESTIMONY BEFORE THIS SUBCOMMITTEE, SUCH STATUTES DO NOT CONTAIN PROVISIONS ANALOGOUS TO THE SEC'S STATEMENTS OF POLICY FOR

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First Mortgage Bonds or Preferred Stock, but such authority is no longer needed in view of the existing securities disclosure requirements and increased sophistication in the investment community, as indicated in Chairman Shad's letter. Moreover, the Statements of Policy, which have actually increased the cost of capital to registered holding companies because of some of the terms mandated therein, are no longer required since the financial markets have changed considerably since the 1920s. Obviously, utilities can no longer dictate the terms of their securities offerings to investment bankers and the public as they were once able to do.

Another aspect of state regulation that merits specific discussion in view of the concerns expressed by the American Public Power Association is the fact that state public service commissions have sufficient authority under existing law to regulate any potential utility combinations that may be inconsistent with the public interest. For example, over half of the states require public service commission approval for the acquisition by a public utility of the securities or assets of another public utility. Virtually all of such states also regulate the sale of utility assets by requiring prior state public service

COMMISSION APPROVAL OF SUCH SALES. OTHER STATES PROHIBIT SUCH SALES TO COMPANIES THAT ARE NOT PUBLIC UTILITIES, WHILE CERTAIN OTHERS ALSO REQUIRE STATE PUBLIC SERVICE COMMISSION APPROVAL PRIOR TO THE ACQUISITION OF A CONTROLLING INTEREST IN A PUBLIC UTILITY.

IN ADDITION TO THE GENERAL APPLICABILITY OF THE FEDERAL ANTITRUST LAWS, SECTION 203(A) OF THE FEDERAL POWER ACT REQUIRES FERC APPROVAL FOR THE ACQUISITION OR DISPOSITION OF UTILITY ASSETS THAT ARE WITHIN THE JURISDICTION OF FERC, AS WELL AS FOR THE MERGER OR CONSOLIDATION OF THOSE ASSETS WITH THOSE OF ANOTHER UTILITY. SECTION 203 OF THE FEDERAL POWER ACT ALSO REQUIRES FERC APPROVAL FOR THE ACQUISITION OF SECURITIES OF ANOTHER PUBLIC UTILITY. ADDITIONALLY, THE CORPORATE LAWS OF MOST STATES REQUIRE SHAREHOLDER APPROVAL OF A MERGER OR A SALE OF ALL OR SUBSTANTIALLY ALL OF A CORPORATION'S PROPERTY, AND MOST PUBLIC UTILITY MORTGAGE BOND INDENTURES AND CHARTERS CONTAIN PROVISIONS PROTECTING THE RIGHTS OF SENIOR SECURITYHOLDERS IN THE EVENT OF SUCH A SALE OR MERGER. CLEARLY, THE INTERESTS OF INVESTORS AND CONSUMERS ARE ADEQUATELY PROTECTED.

FINALLY, I WANT TO BRIEFLY MENTION THE QUESTION OF AFFILIATE TRANSACTIONS. AS MR. FLOYD W. LEWIS, THE DISTINGUISHED CHAIRMAN OF MIDDLE SOUTH UTILITIES, EXPLAINED WITH SPECIFIC EXAMPLES IN HIS TESTIMONY, BOTH FERC AND THE

STATE PUBLIC SERVICE COMMISSIONS HAVE THE AUTHORITY TO SCRUTINIZE TRANSACTIONS AMONG AFFILIATES, BOTH WITHIN AND OUTSIDE HOLDING COMPANY SYSTEMS, AND, IN FACT, MANY STATE PUBLIC SERVICE COMMISSIONS HAVE BEEN DOING SO FOR DECADES. IN A LARGE NUMBER OF STATES, THIS AUTHORITY IS EXPLICITLY CONTAINED IN STATUTORY PROVISIONS REQUIRING SPECIFIC APPROVAL OF SUCH TRANSACTIONS, WHILE IN OTHER STATES TRANSACTIONS AMONG AFFILIATES ARE REGULATED IN THE RATEMAKING PROCESS THROUGH THE DISALLOWANCE BY THE STATE PUBLIC SERVICE COMMISSION OF ANY CHARGES FOUND TO BE "UNREASONABLE". IN THE EXERCISE OF ITS WHOLESALE RATEMAKING POWER, FERC ALSO MONITORS SUCH TRANSACTIONS. IN MY OPINION, CLAIMS THAT STATE REGULATION IS NOT ADEQUATE IN THIS AREA SHOULD BE GREETED WITH CONSIDERABLE SKEPTICISM.

TRANSACTIONS BETWEEN DUKE POWER COMPANY AND ITS WHOLLY-OWNED SUBSIDIARY, MILL POWER SUPPLY COMPANY, PROVIDE A PERTINENT ILLUSTRATION OF EFFECTIVE STATE REGULATION OF TRANSACTIONS AMONG AFFILIATES. FOR 72 YEARS MILL POWER HAS SOLD ELECTRICAL EQUIPMENT AND SUPPLIES TO DUKE POWER AT MARKET PRICES. THE NORTH CAROLINA UTILITIES COMMISSION AND THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA NOT ONLY REGULATE THE ALLOCATION OF COSTS BETWEEN DUKE POWER AND MILL POWER, BUT THEY ALSO ELIMINATE FOR RATEMAKING PURPOSES FROM

DUKE POWER'S COST OF SERVICE ANY PROFIT EARNED BY MILL POWER ON SUCH TRANSACTIONS. THE NORTH CAROLINA AND SOUTH CAROLINA COMMISSIONS WOULD CONTINUE TO REGULATE SUCH TRANSACTIONS EFFECTIVELY EVEN IF THE HOLDING COMPANY ACT WERE TO BE REPEALED AND DUKE POWER WERE TO REORGANIZE INTO A HOLDING COMPANY SYSTEM.

IN ADDITION TO THE DRAMATIC CHANGES IN THE STRUCTURE OF THE INDUSTRY BROUGHT ABOUT BY THE HOLDING COMPANY ACT AND THE EVOLUTION OF UTILITY REGULATION AT THE STATE LEVEL FROM ITS FORMATIVE STAGES INTO THE STRONG, COMPREHENSIVE REGULATORY SYSTEMS THAT EXIST TODAY, THERE ARE TWO OTHER SIGNIFICANT FACTORS REFERRED TO BY CHAIRMAN SHAD IN HIS LETTER THAT MERIT ADDITIONAL DISCUSSION. THE FIRST CONCERNS THE DISCLOSURE REQUIREMENTS OF THE SECURITIES ACT OF 1933 (33 ACT) AND THE REPORTING REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934 (34 ACT). THE SECOND RELATES TO DEVELOPMENTS IN THE ACCOUNTING PROFESSION THAT HAVE TAKEN PLACE IN THE LAST 50 YEARS. THESE CONSIDERATIONS ARE SIGNIFICANT IN THAT VIRTUALLY ALL OF THE QUESTIONABLE PRACTICES THAT LED TO THE PASSAGE OF THE HOLDING COMPANY ACT RAISED SECURITIES AND ACCOUNTING ISSUES. THEY COULD BE SUMMARIZED AS FOLLOWS: (1) THE "PYRAMIDING" OF COMPANIES IN A HOLDING COMPANY SYSTEM RESULTED IN A HIGHLY LEVERAGED CAPITAL STRUCTURE WITH A RELATIVELY SMALL NUMBER OF PEOPLE CONTROLLING EXTENSIVE BUSINESS

ENTERPRISES; (2) INACCURATE AND MISLEADING ACCOUNTING METHODS AND PRACTICES WERE USED TO MAKE INVESTMENTS IN PUBLIC UTILITIES APPEAR MORE ATTRACTIVE; AND (3) HOLDING COMPANIES MANIPULATED THEIR SECURITIES TRANSACTIONS.*

ALTHOUGH PASSAGE OF THE HOLDING COMPANY ACT ACTUALLY OCCURRED AFTER PASSAGE BY THE CONGRESS OF THE 33 ACT AND THE 34 ACT, IT IS QUITE CLEAR THAT THOSE PIECES OF LEGISLATION HAVE PROVED FAR MORE EFFECTIVE THAN ANTICIPATED. FOR INSTANCE, SENATOR BURTON K. WHEELER, THE SENATE FLOOR MANAGER FOR THE HOLDING COMPANY ACT, DISMISSED THE 33 ACT AS MERELY A "PUBLICITY ACT -- A 'TRUTH IN SECURITIES ACT' -- NO MORE THAN THAT." "IT DOES NOT," HE DECLARED, "ACTUALLY CONTROL THE ISSUE OF ANY SECURITIES -- IT IS MERELY DESIGNED TO TRY TO GET THE TRUTH TOLD ABOUT SECURITIES WHICH ARE ISSUED TO THE PUBLIC, SO THAT IF THE PUBLIC HAS THE TIME AND THE ABILITY IT CAN TO SOME EXTENT FIND OUT WHAT IS BEING SOLD TO IT." CONSEQUENTLY, SENATOR WHEELER INSISTED THAT THE HOLDING COMPANY ACT NOT RELY ON THE CONCEPT OF DISCLOSURE, BUT, INSTEAD, ON AN UNPRECEDENTED DIRECT INVOLVEMENT BY THE SEC IN FUNDAMENTAL MANAGEMENT DECISIONS CONCERNING A HOLDING COMPANY'S OPERATIONS.

FOR OBVIOUS REASONS, THERE IS NO NEED FOR ME TO DISCUSS IN DETAIL WITH THIS SUBCOMMITTEE THE FEDERAL SECURI-

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* SEE ANNEX A HERETO.

TIES LAWS. HOWEVER, FOR THOSE WHO ARE NOT EXPERTS, IT IS IMPORTANT TO NOTE THAT THE CONCEPT OF DISCLOSURE TO INVESTORS OF MATERIAL INFORMATION FORMS THE BACKBONE OF OUR SECURITIES LAWS. THE 33 ACT, FOR EXAMPLE, PROVIDES THAT NO COMPANY, INCLUDING PUBLIC UTILITIES, MAY MAKE A PUBLIC DISTRIBUTION OF ITS SECURITIES WITHOUT FIRST FILING A REGISTRATION STATEMENT RELATING TO THOSE SECURITIES WITH THE SEC. THE CONTENTS OF SUCH REGISTRATION STATEMENT MUST CONFORM TO THE SEC'S RULES AND REGULATIONS, AND THE REGISTRATION STATEMENT MUST DISCLOSE ALL INFORMATION NECESSARY TO MAKE AN INFORMED INVESTMENT DECISION.

SIMILARLY, RULES AND REGULATIONS PROMULGATED BY THE SEC PURSUANT TO THE 34 ACT PROVIDE FOR THE CONTINUOUS DISCLOSURE TO AN INVESTOR OF MATERIAL INFORMATION THROUGH A SYSTEM OF PERIODIC REPORTING. FOR EXAMPLE, A COMPANY IS REQUIRED TO FILE CURRENT, QUARTERLY AND ANNUAL REPORTS WITH THE SEC DISCLOSING CERTAIN MATERIAL INFORMATION. SUCH REPORTS MUST ALSO BE FILED WITH EVERY NATIONAL SECURITIES EXCHANGE ON WHICH THE SECURITIES OF THAT COMPANY ARE BEING TRADED. THE SEC ALSO REQUIRES THAT SHAREHOLDERS BE FURNISHED WITH INFORMATION RELATING TO MATTERS ON WHICH THEY VOTE, AND COMPANIES MUST FURNISH SHAREHOLDERS WITH ANNUAL REPORTS CONCERNING THEIR OPERATIONS. SUCH DISCLOSURE UNDER BOTH THE 33

ACT AND THE 34 ACT PROVIDES AN INVESTOR WITH DETAILED INFORMATION ON BOTH THE FINANCIAL CONDITION AND OPERATIONS OF A COMPANY, INCLUDING PUBLIC UTILITY COMPANIES.

ADDITIONAL PROTECTION IS AFFORDED BY THE TRUST INDENTURE ACT OF 1939. THIS FEDERAL LEGISLATION PRESCRIBES CERTAIN STANDARDS FOR INDENTURES AND TRUSTEES OF DEBT SECURITIES SOLD TO THE PUBLIC. THIS STATUTE IS PARTICULARLY RELEVANT TO UTILITIES IN VIEW OF THE LARGE AMOUNTS OF DEBT SECURITIES THAT ARE TYPICALLY SOLD BY THEM. ALSO, VIRTUALLY EVERY STATE NOW HAS SECURITIES OR "BLUE SKY" LAWS THAT REGULATE THE SALE OF SECURITIES IN THAT STATE.

INVESTORS RECEIVE ADDITIONAL PROTECTION DUE TO THE FACT THAT ACCOUNTING STANDARDS AND PRACTICES HAVE CHANGED CONSIDERABLY SINCE THE PASSAGE OF THE HOLDING COMPANY ACT. PUBLIC UTILITIES ARE NOW SUBJECT TO THE UNIFORM SYSTEM OF ACCOUNTS PROMULGATED BY FERC AND TO SIMILAR STRINGENT ACCOUNTING CONTROLS AT THE STATE LEVEL THAT WERE NOT IN PLACE AT THE TIME THE HOLDING COMPANY ACT WAS PASSED. ALSO, THE INDEPENDENCE OF CERTIFIED PUBLIC ACCOUNTANTS IS MUCH GREATER NOW, AND THAT INDEPENDENCE IS VIRTUALLY GUARANTEED BY CURRENT PRACTICE. MOREOVER, IN ADDITION TO THE DETAILED ACCOUNTING RULES AND REGULATIONS SET FORTH BY THE SEC IN REGULATION S-X, ACCOUNTANTS MUST ALSO FOLLOW THE ACCOUNTING PRINCIPLES ESTAB-

LISHED BY THE FINANCIAL ACCOUNTING STANDARDS BOARD. THE SEC AND BODIES IN THE PRIVATE SECTOR ALSO NOW HAVE PROCEDURES FOR MONITORING THE ETHICAL STANDARDS OF THE PROFESSION.

CLEARLY, THE HOLDING COMPANY ACT IS UNNECESSARY IN THESE RESPECTS. FOR IF THE ACT WERE REPEALED, ALL PUBLICLY-HELD UTILITY HOLDING COMPANIES WOULD CONTINUE TO BE SUBJECT TO THE FINANCIAL DISCLOSURE REQUIREMENTS AND OTHER PROVISIONS OF THE FEDERAL SECURITIES LAWS.

MR. CHAIRMAN, IN HIS TESTIMONY CONGRESSMAN TAUZIN ALLUDED TO THE FACT THAT UNLIKE OTHER FEDERAL STATUTES, THE HOLDING COMPANY ACT DIRECTLY INVOLVES THE SEC IN FUNDAMENTAL MANAGEMENT DECISIONS SUCH AS THOSE INVOLVING THE TERMS AND CONDITIONS, METHOD, AND TIMING OF SECURITIES ISSUANCES. MOREOVER, THE ACT ALSO PROVIDES THE SEC WITH BROAD POWERS TO INFLUENCE EVEN MORE WIDE-RANGING MANAGEMENT DECISIONS. AS CHAIRMAN SHAD NOTED IN HIS LETTER:

> THE ACT, HOWEVER, CONTINUES TO HAVE SIGNIFICANT INFLUENCE ON THE FINANCING AND DIVERSIFICATION DECISIONS OF A MUCH LARGER PORTION OF THE INDUSTRY [THAN THE 14 REGISTERED HOLDING COMPANIES]. APPROXIMATELY EIGHTY HOLDING COMPANY SYSTEMS OPERATE UNDER VARIOUS EXEMPTIONS FROM THE ACT, AND MANY UTILITIES MAY BE RELUCTANT TO FORM HOLDING COMPANIES BECAUSE THEY WOULD THEN HAVE TO REGISTER UNDER THE ACT OR QUALIFY FOR AN EXEMPTION. FURTHERMORE, IN THIS TIME OF ENERGY SHORTAGES AND THE RECOGNIZED

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NEED TO DEVELOP NEW ENERGY RESOURCES, THE ACT MAY DETER NON-UTILITIES FROM PARTICIPATING IN COGENERATION PROJECTS OR OTHER SUCH ACTIVITIES BECAUSE OF THE CONSEQUENCES OF BECOMING SUBJECT TO THE ACT.

AS MR. FLOYD W. LEWIS INDICATED IN HIS TESTIMONY, EXEMPTIONS UNDER THE ACT ARE WHOLLY DISCRETIONARY AND MAY BE REVOKED BY THE SEC AT ANY TIME, EVEN ON A RETROACTIVE BASIS. THE CONSEQUENCES TO A UTILITY HOLDING COMPANY OF LOSING AN EXEMPTION UNDER THE ACT ARE VERY SEVERE, INDEED. THIS IS ESPECIALLY TRUE OF COMBINATION ELECTRIC AND GAS UTILITIES THAT COULD CONCEIVABLY BE SUBJECT TO A SECTION 11 SIMPLIFICATION PROCEEDING, RESULTING IN THE FORCED SALE OF EITHER THE ELECTRIC OR GAS UTILITY BUSINESS. SIMILARLY, MANY COMPANIES, INCLUDING PRESENTLY EXEMPT HOLDING COMPANIES, ARE SIMPLY UNWILLING TO COMMIT MATERIAL ASSETS TO MORE PROFITABLE, NON-UTILITY BUSINESSES IF THEY RISK THE RETROACTIVE LOSS OF THEIR EXEMPTION OR THE FORCED DIVESTITURE OF SUCH ASSETS. IN VIEW OF THE OVERWHELMING REGULATORY BURDENS IMPOSED UPON REGISTERED HOLDING COMPANIES, NO UTILITIES WANT TO RISK BECOMING SUBJECT TO REGISTRATION UNDER THE ACT.

MR. CHAIRMAN, YOUR DISTINGUISHED SUBCOMMITTEE HAS ALREADY HEARD TESTIMONY THAT THE UTILITY INDUSTRY IS EXPERIENCING SERIOUS FINANCIAL DIFFICULTIES. YOU HAVE ALSO HEARD THAT THE HOLDING COMPANY ACT NO LONGER SERVES ANY

USEFUL PURPOSE, AND, IN FACT, PRESENTS BARRIERS TO ACTIVITIES THAT COULD PROVIDE BENEFITS TO BOTH INVESTORS AND CONSUMERS. I RESPECTFULLY SUBMIT THAT DIVERSIFICATION BY UTILITIES INTO MORE PROFITABLE, NON-UTILITY BUSINESSES WOULD PROVIDE ECONOMIC BENEFITS TO PUBLIC UTILITY INVESTORS AND CONSUMERS ALIKE AND WOULD RESULT IN A BETTER OVERALL FINANCIAL CONDITION FOR THE INDUSTRY, WITH ATTENDANT BENEFITS TO OUR NATION. THIS COULD BEST BE ACCOMPLISHED BY THE USE OF A HOLDING COMPANY STRUCTURE WITH SEPARATE CORPORATE SUBSIDIARIES FOR THE UTILITY AND NON-UTILITY BUSINESSES. THIS STRUCTURE WOULD FACILITATE EFFECTIVE STATE REGULATION OF THE UTILITY BUSINESS, MINIMIZE THE POSSIBILITY OF ANY LOSSES OR LIABILITIES TO THE UTILITY AND ITS RATEPAYERS, PREVENT CROSS-SUBSIDIZATION AND FACILITATE THE RAISING OF CAPITAL ON MORE REASONABLE TERMS, THUS BENEFITING RATEPAYERS.

THIS SUBCOMMITTEE HAS PREVIOUSLY HEARD TESTIMONY FROM MR. CHARLES BENORE THAT THE HOLDING COMPANY ACT IS HURTING THE UTILITY INDUSTRY'S FINANCIAL PERFORMANCE BY PROVIDING SIGNIFICANT IMPEDIMENTS TO DIVERSIFICATION. ADDITIONAL EVIDENCE ON THIS POINT IS FOUND IN THE ECONOMIC STUDY PREPARED BY THE CABOT CONSULTING GROUP THAT WE HAVE PREVIOUSLY FURNISHED THE SUBCOMMITTEE STAFF. MR. BENORE ALSO INDICATED THAT HE WAS MORE COMFORTABLE WITH THE STOCKS OF DIVERSIFIED

UTILITIES BECAUSE OF THE ADDITIONAL PROFIT OPPORTUNITIES THAT THE DIVERSIFIED OPERATIONS PRESENTED; HE ALSO SUGGESTED THAT UTILITY EXECUTIVES WERE CAPABLE OF MANAGING A DIVERSIFIED COMPANY AND THAT, ON BALANCE, THE HISTORICAL EXPERIENCE OF DIVERSIFIED UTILITIES HAS BEEN QUITE GOOD. IN HIS TESTIMONY, CONGRESSMAN CORCORAN QUOTED THE CABOT STUDY, "DIVERSIFICATION, A BUSINESS OPTION AND NORMAL PRACTICE IN MOST INDUSTRIES, CAN SELECTIVELY HELP INCREASE EARNINGS OR DECREASE RISK AND MAY IMPROVE THE ATTRACTIVENESS OF BOTH ELECTRIC AND GAS UTILITY SECURITIES AS A RESULT." CONGRESSMAN CORCORAN ALSO NOTED THAT DIVERSIFICATION WOULD FACILITATE THE RAISING OF CAPITAL FOR THE UTILITY AND THUS REDUCE COSTS TO THE RATEPAYER.

MANY OTHERS IN THE INVESTMENT COMMUNITY ALSO BELIEVE THAT DIVERSIFICATION COULD PROVIDE BENEFITS TO INVESTORS AND CONSUMERS ALIKE. MORGAN STANLEY & CO. INCORPORATED, FOR EXAMPLE, RECENTLY SUGGESTED TO A NARUC COMMITTEE THE FOLLOWING REASONS FOR A UTILITY TO DIVERSIFY. I WOULD LIKE TO SHARE THEM WITH YOU NOW:

1. TO EARN A HIGHER RATE OF RETURN THAN AVAILABLE IN THE UTILITY BUSINESS, AND THEREBY INCREASE EARNINGS PER SHARE AND MARKET-TO-BOOK RATIOS.

2. TO ENHANCE INVESTMENT COMMUNITY IMAGE, INCREASE P/E [PRICE/EARNINGS] RATIOS, AND OVER TIME TO PRODUCE A LOWER COST OF CAPITAL.

3. To provide another base of earnings to reduce the risk associated with exposure to a single line of business.

4. To ensure availability of raw materials (and product markets) through vertical integration.

5. To obtain maximum utilization of a company's existing strengths or assets.

Mr. Chairman, if I may summarize some of the testimony on diversification that the Subcommittee has already heard, there are two significant points. First, it should be clear that successful diversification using a holding company structure would facilitate capital formation by making the holding company's securities more attractive to investors, resulting in a lower cost of capital for the utility's ratepayers. Secondly, diversification could actually <u>reduce</u> risk levels over those of utility companies that remain only in the utility business.

Mr. Chairman, I would now like to spend a few moments talking specifically about Duke Power Company. As I indicated at the beginning of my testimony, Duke Power Company does business in both North and South Carolina. As such, if Duke Power were to form a holding company as the preferred structure for any diversification activities, it would have to register as a registered holding company under the Act since Duke Power would not qualify for one of the

EXEMPTIONS PRESENTLY CONTAINED IN SECTION 3 OF THE ACT. FOR MANY OF THE REASONS YOU HAVE HEARD, DUKE POWER SIMPLY WOULD NOT FORM A HOLDING COMPANY UNDER THESE CIRCUMSTANCES. YET, WE BELIEVE THAT A HOLDING COMPANY STRUCTURE WOULD BE THE PREFERABLE FORM OF CORPORATE STRUCTURE FOR US TO USE IN ORDER TO ACHIEVE OUR LONG-TERM CORPORATE GOALS.

DUKE POWER COMPANY'S MAJOR CORPORATE OBJECTIVE IS, AND WILL CONTINUE TO BE, TO EXCEL AS AN ELECTRIC UTILITY -- TO PROVIDE HIGH QUALITY ELECTRIC SERVICE TO CONSUMERS AT AFFORDABLE PRICES WHILE AT THE SAME TIME EARNING A COMPENSATORY RETURN FOR ITS INVESTORS. WE HOPE, HOWEVER, TO ENHANCE OUR COMPANY'S EXCELLENCE BY FULLY DEVELOPING ITS DEMONSTRATED TALENTS AND EXPANDING THEM, AS APPROPRIATE, INTO NON-REGULATED MARKETS. THESE EFFORTS WILL BE SERVICE-ORIENTED, NOT CAPITAL INTENSIVE, AND THEY WILL UTILIZE EXPERTISE AND NON-UTILITY ASSETS DESIGNED TO PROVIDE SYNERGISTIC BENEFITS TO OUR CORE ELECTRIC UTILITY BUSINESS.

FOR EXAMPLE, DUKE'S WHOLLY-OWNED SUBSIDIARY, CRESCENT LAND AND TIMBER CORP., OWNS APPROXIMATELY 270,000 ACRES OF NON-UTILITY LAND. FOR YEARS CRESCENT HAS CONDUCTED FORESTRY AND LIMITED RECREATIONAL LAND DEVELOPMENT ACTIVITIES. AT THE PRESENT TIME, IT IS INVOLVED IN DISCUSSIONS WITH A MAJOR TEXTILE FIRM IN OUR SERVICE TERRITORY CONCERNING

THE POSSIBILITY OF UTILIZING WOOD CHIPS AS A NEW SOURCE OF ENERGY, POSSIBLY FOR THE CO-GENERATION OF ELECTRICITY. CRESCENT HAS ALSO RECENTLY ENGAGED THE SERVICES OF A GEOLOGICAL CONSULTING FIRM TO DETERMINE IF ITS LAND CONTAINS OTHER NATURAL RESOURCES THAT COULD BE PROFITABLY EXPLOITED.

AS I HAVE MENTIONED, MILL POWER SUPPLY COMPANY, ANOTHER SUBSIDIARY, HAS BEEN IN THE ELECTRICAL EQUIPMENT BUSINESS FOR 72 YEARS. IT WAS ORIGINALLY ESTABLISHED TO MARKET EQUIPMENT TO ENABLE INDIVIDUAL BUSINESSES TO CONVERT FROM WATER POWER TO ELECTRIC ENERGY, AND OVER THE YEARS MILL POWER HAS EXPANDED ITS BUSINESS TO INCLUDE OTHER FORMS OF MAJOR ELECTRICAL EQUIPMENT. WE BELIEVE THAT IN THE FUTURE MILL POWER SHOULD BE EFFECTIVELY POSITIONED TO MARKET DEVELOPING ENERGY AND CONSERVATION TECHNOLOGIES. IN THIS REGARD, MILL POWER COULD PROVIDE SYNERGISTIC BENEFITS FOR DUKE POWER'S LOAD MANAGEMENT PROGRAM. ANOTHER COMPANY IN OUR AD HOC GROUP, PACIFIC LIGHTING CORPORATION, WHOSE SOUTHERN CALIFORNIA GAS COMPANY IS THE LARGEST GAS DISTRIBUTOR IN THE UNITED STATES, HAS ALSO DIVERSIFIED INTO ENERGY CONSERVATION AREAS AS PART OF ITS LONG-TERM STRATEGIES. FOR EXAMPLE, ITS DUAL FUEL SYSTEMS SUBSIDIARY MANUFACTURES AND MARKETS EQUIPMENT THAT ENABLES VEHICLES TO OPERATE ON COMPRESSED NATURAL GAS INTERCHANGEABLY WITH

GASOLINE. ALSO, ANOTHER SUBSIDIARY OF PACIFIC LIGHTING IS DEVELOPING A SCRUBBER SYSTEM THAT CLEANS AND UPGRADES THE QUALITY OF "WASTE" BIOGAS PRODUCED FROM SEWAGE AND LANDFILLS. INCREASED ENERGY CONSERVATION IS, OF COURSE, ONE NECESSARY ELEMENT IN OUR NATION'S ENERGY FUTURE.

FINALLY, DUKE POWER'S DESIGN ENGINEERING AND CONSTRUCTION TEAM, SOME 8,000 STRONG, HAS DEVELOPED A UNIQUE CAPABILITY IN OUR INDUSTRY. IT DESIGNS AND CONSTRUCTS, IN-HOUSE, ALL OF DUKE POWER COMPANY'S POWER PLANTS. THESE PLANTS ARE THE MOST EFFICIENT IN THE INDUSTRY. AS DUKE POWER'S NEED FOR NEW CONSTRUCTION DECLINES, ITS DESIGN ENGINEERING AND CONSTRUCTION CAPABILITY COULD BE MADE AVAILABLE TO OTHERS. FOR EXAMPLE, OUR DESIGN ENGINEERING AND CONSTRUCTION TEAM HAS ALREADY UNDERTAKEN AS A PILOT PROJECT THE DESIGN OF A NUCLEAR WASTE DISPOSAL FACILITY FOR ANOTHER UTILITY AND IS EXPLORING OTHER SIMILAR OPPORTUNITIES.

THESE ARE EXAMPLES OF THE KINDS OF DIVERSIFIED ACTIVITIES DUKE POWER PLANS TO PURSUE IN FURTHERANCE OF ITS LONG-TERM CORPORATE STRATEGIES. THEY ARE COMPATIBLE WITH THE CORE UTILITY BUSINESS, BUILDING UPON IT WITHOUT REQUIRING A LARGE INFUSION OF CAPITAL, A BASIC CHANGE IN MANAGEMENT STYLE, OR A UNIQUE KIND OF EXPERTISE. MOREOVER, WE BELIEVE THAT THE INTERESTS OF BOTH INVESTORS AND CONSUMERS WOULD BE MAXIMIZED

IF WE WERE TO UTILIZE A HOLDING COMPANY STRUCTURE FOR SUCH ACTIVITIES. WHILE I CANNOT SPEAK FOR OTHER UTILITIES, IT IS MY BELIEF THAT THEY WOULD PURSUE A SIMILAR COURSE IN SEEKING OPPORTUNITIES FOR DIVERSIFICATION.

MR. CHAIRMAN, I RESPECTFULLY URGE THE SUBCOMMITTEE TO REMOVE THE UNNECESSARY REGULATORY BURDENS THAT THE HOLDING COMPANY ACT IMPOSES ON THE ELECTRIC AND GAS UTILITY INDUSTRY. I WOULD ALSO LIKE TO REPEAT A POINT MADE BY CONGRESSMAN CORCORAN IN THE CONCLUSION OF HIS TESTIMONY, "DIVERSIFICATION IS NOT A PANACEA NOR THE SOLE SOLUTION TO THE CONTEMPORARY FINANCIAL PROBLEMS OF THE INDUSTRY OR ITS RATEPAYERS. BUT, IN AN ECONOMY WHERE REGULATED UTILITIES MUST COMPETE IN THE CAPITAL MARKETS WITH UNREGULATED INDUSTRIES AND THE FEDERAL GOVERNMENT FOR LIMITED AMOUNTS OF CAPITAL, DIVERSIFICATION REPRESENTS ONE INNOVATIVE MANAGEMENT TECHNIQUE THAT COULD BE USED BY THE INDUSTRY TO FACILITATE CAPITAL FORMATION AND, THUS, ITS LONG-TERM SURVIVAL."

MR. CHAIRMAN, I WOULD LIKE TO THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY. THIS CONCLUDES MY PREPARED REMARKS.

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ANNEX A

(1) Pyramiding companies owning or controlling the operating companies for the purpose of enabling a minimum of investment to control a maximum of operating facilities, involving a greedy and highly speculative type of organization detrimental to the financial and economic welfare of the Nation.

(2) Loading the fixed-capital account of public utilities with arbitrary or imaginary amounts in order to establish a base for excessive rates.

(3) Writing up the fixed assets without regard to the cost thereof, with the result of watering the stock or creating a fictitious surplus.

(4) Engaging in transactions of purchase and sale of property or securities with controlled or subsidiary companies for the purpose of recording arbitrary profits or fixing valuations unjustified by market values.

(5) Exaction of payments from affiliated or controlled companies for services in excess of cost or value of such services.

(6) Gross disregard of prudent financing in excessive issues of obligations, imperiling the solvency of the company and involving excessive charges for interest, discount, commissions, redemption, etc.

(7) Manipulating the security markets to deceive stockholders, bondholders, or potential purchasers of its securities.

(8) Putting funds in the call-loan market with the result of greatly stimulating speculation.

(9) Excessive use of conversion privileges for bonds and preferred stocks and of purchase warrants and

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options with the effect of inducing investors to part with conservative investments for speculative ones.

(10) Misstatement of earned surplus, or failure to distinguish earned from capital surplus, and making payment of dividends from the latter.

(11) Deceptive or illusory methods of dividing, or pretending to divide, earnings or profits.

(12) Including imaginary (or "putative") interest in construction costs of a public utility and counting it as a part of earnings.

(13) Deceptive or unsound methods of accounting for assets and liabilities, costs, operating results and earnings, including write-ups, unrealized or fictitious profits, stock dividends, etc.

(14) Corporate organization which gives powers inconsistent with a just division of responsibilities and emoluments as between various groups or parties furnishing capital by loan or by contribution, either directly or indirectly by purchase, succession, or otherwise.

(15) Issuing special voting or management stock giving control at small cost in order to promote the interests of selfish cliques, against the interest and safety of the general stockholders.

(16) Unsafe or mischievous methods of securing loans to the detriment of the lender.

(17) Intercompany financing on a basis disadvantageous to operating company borrowers or lenders.

(18) Evasion of State laws in effecting sales of security issues.

(19) Effecting pretended corporate reorganizations principally for the purpose of evading the payment of Federal income taxes.

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Testimony of

John G. L. Cabot
Senior Vice President

Cabot Corporation

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today on behalf of Cabot Corporation in support of repeal or significant reform of the Public Utility Holding Company Act of 1935. My name is John Cabot. I am Senior Vice President of Cabot Corporation with responsibility for the overall operation, profitability and return on investment of the company's Energy Group.

BACKGROUND ON CABOT

Cabot was founded exactly 100 years ago. It is a Boston-based manufacturer with annual sales of approximately $1.6 billion. Our businesses include energy, specialty metals and performance chemicals. In the Energy Group, Cabot explores for and produces crude oil and natural gas, operates gas processing plants, natural gas pipelines and a distribution system, and imports and sells liquefied natural gas (LNG). The Engineered Products Group produces and sells specialty metals, alloys, compounds and materials for use in the aerospace, chemical processing, nuclear, paper, pollution control, aluminum and electronics industries. Energy absorbing resins and noise control products are also manufactured by the Engineered Products Group through a subsidiary, E-A-R Corporation. In the Performance Chemicals Group, Cabot is the leading worldwide producer of carbon black, a chemical used primarily as a reinforcing agent in rubber tires; and is the largest domestic producer of CAB-O-SIL fumed silica, used principally as a reinforcing agent in silicone rubber and thickening agent for liquids.

A small part of Cabot's business is a state-regulated natural gas utility which operates as a division in West Virginia. In calendar year 1980, Cabot utility revenues of $15.5 million represented less than one percent of Cabot Corporation's consolidated worldwide sales. Being approximately 99 percent diversified puts us at the extreme end of the range of companies that have both utility and non-utility interests (Chart 1).

Cabot entered the utility business quite by accident. In the late 1800s and early 1900s, the company explored for and produced natural gas in West Virginia and Pennsylvania to suppply its carbon black manufacturing operations. The company permitted rural West Virginians to purchase excess gas supplies from

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Cabot's pipelines. These sales became regulated as state and federal utility regulation evolved. The Cabot utility is currently regulated by the West Virginia Public Service Commission.

At the April 27 hearing, questions were raised by witnesses concerned about prudent diversification and associated risks. As a diversified concern with over $1.6 billion in sales, we believe we can address those concerns. We believe that our record confronts directly the implicit assumption in the Public Utility Holding Company Act--that mixing utility businesses with non-utility businesses is somehow bad.

Cabot Corporation has experienced outstanding growth in recent years. Our return on equity has averaged 24.7 percent over the last three years. We are a world leader in the carbon black and specialty metals markets. In short, we have been successful at managing a diversified business. We have successfully managed a utility business as well. Over the last decade we have had the lowest retail gas rates of any major West Virginia utility and we have a better record of gas availability during the last decade of shortages.

Even though we have been a success in both utility and non-utility business, the Holding Company Act places a burden on our organization. The utilities which would like to start diversifying have advised you of the problems caused for them by the Act. Cabot is at the other end of the spectrum. The Act forces us to organize our business in an awkward way and makes it very complicated for us to expand utility operations--for example, to another state, should we wish to do so.

A utility has special regulatory requirements which argue for separating utility operations from other businesses within the overall corporate structure. The logical way for Cabot to do this would be to operate its West Virginia utility as a subsidiary. But, despite approaches to the SEC in 1968 and 1980, we have been unable to obtain an exemption from the Holding Company Act, and we have been forced to operate our utility in the parent company. If we were to place our utility business in a subsidiary, the Corporation would then become subject to the requirements of the Act, and we would have to divest all businesses not "reasonably incidental" to our utility business. In short, we would have to sell most of Cabot Corporation.

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As a result, Cabot has been forced to operate its utility as a division, with the entire parent company as the utility of record in West Virginia, rather than as a wholly-owned subsidiary. This means, from a practical standpoint, economic inefficiencies are created that burden the corporation, its utility and its customers. For example, the reporting burden on the parent corporation is great. We believe that no counsel of any other major corporation would recommend it enter the utility business unless the utility could operate as a subsidiary. In addition, in past proceedings before the state regulatory commission, neither the commission nor Cabot has been able to satisfactorily define what the utility is in terms of assets, debt and equity and liability for taxes. This has made rate-making an uncertain procedure at best. If the Holding Company Act was repealed or changed, Cabot could operate the utility as a subsidiary. The utility would be a well defined separate corporate entity with known assets, debt and equity and taxes, with the flexibility to assume a typical utility industry debt structure. Generally, utility industries are characterized by more favorable debt to equity ratios, which have historically reduced the cost of capital to utilities. We do not understand why Cabot or any other company should be prevented from organizing its businesses in a straightforward, logical manner.

Clearly, the most important contribution we can make today is to reassure this subcommittee that relaxation of the Act is in the best interests of the consumer and the stockholder. We believe that a diversified company can be just as committed to its utility customers as a non-diversified enterprise; that the ratepayers and stockholders can benefit from the relationship and that there is no reason, then, to continue to isolate utilities from other enterprises. They can be run together, efficiently and profitably. Rather than talk in theoretical terms about what would be done with the relaxation or repeal of the Holding Company Act, we believe it would be more valuable for this Committee to look at empirical evidence--the record of the Cabot utility.

I am proud of our record in West Virginia. The chart before you (Chart 2) shows the recent average price per household for natural gas for the major retail utilities in West Virginia based on pending rate cases in November 1981. As you can see, the average price ranges from $5.22 per mcf to $3.42 per mcf with Cabot at the low end of the scale. Several of these companies are registered holding companies under the Act and are subject to restrictions which probably

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affect their results. In any case, from our point of view Cabot's lower gas rates support the notion that a diversified company with a utility can deliver services efficiently and to the benefit of those utility customers.

Cabot can sell gas more cheaply because our West Virginia operations are a compact, efficient blend between the residential and industrial user, and the system is properly incorporated into the Cabot Energy Group. We are a large driller in West Virginia and have been in the business for a long time. We began an aggressive gas development program in 1970. Our program was a success, and as it turns out, invaluable to the utility because enough new production was generated to more than cover our utility's needs. Each business—production and distribution—was run independently, run at its own pace and not as the handmaiden for the other. Thus, our natural gas production was expanded as fast as opportunity would allow, not just to supply our utility. The utility ultimately benefitted because we were never short of gas. In fact, we are unusual in the state because we have had no sales restrictions in the last decade, as the final chart before you indicates (Chart 3). In short, we run our utility like a business, where we look for opportunities to blend the utility needs into our other businesses, not vice versa.

An important public policy issue before the Congress is whether it is in the public interest to maintain the wall erected by the Act between public utilities and other businesses. We believe that this wall has created artificial economic distortions and that its removal would permit some benefits to accrue to utility customers. Again, there is no reason to believe that a utility cannot benefit from its association with a generally non-utility oriented business. The question is not whether diversification is a good idea, because in some cases it is not, but whether it should be prohibited by statute in all cases—even when it is a positive step. There are numerous checks, such as through state regulatory authorities, to prevent poorly thought out diversification plans. But, there is no reason to penalize everyone, through a wide-ranging federal statute like the Holding Company Act, from pursuing prudent diversification practices.

In my experience, the general requirements for utility and non-utility management are similar; both need to maintain a desirable return on stockholders' equity and to set operating and financial objectives. Although techniques and

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technology used in operations may differ, the standards of efficiency, quality and properly adapting to new conditions and opportunites are equally important to both businesses. The question before this subcommittee is whether the Holding Company Act should continue to isolate utilities from the experience of free-market enterprises and vice versa.

Beyond these points, which I would be happy to discuss in greater detail today or at a later date, I would like to echo some of the statements made here this morning that indicate that virtually every important regulatory section of the Act is covered by other federal and state regulations. These points are covered in detail in an attachment to my oral testimony which we will submit for the record.

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to present our views to you on this important issue. We hope that the Senate will move to repeal or significantly reform the Holding Company Act this year so that Cabot can organize our utility as a subsidiary and other, even more restricted companies may begin to enjoy the financial flexibility and rewards of the free market. I would be happy to answer any questions you might have.

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Chart 1

CABOT CORPORATION
Net Sales vs Utility Sales

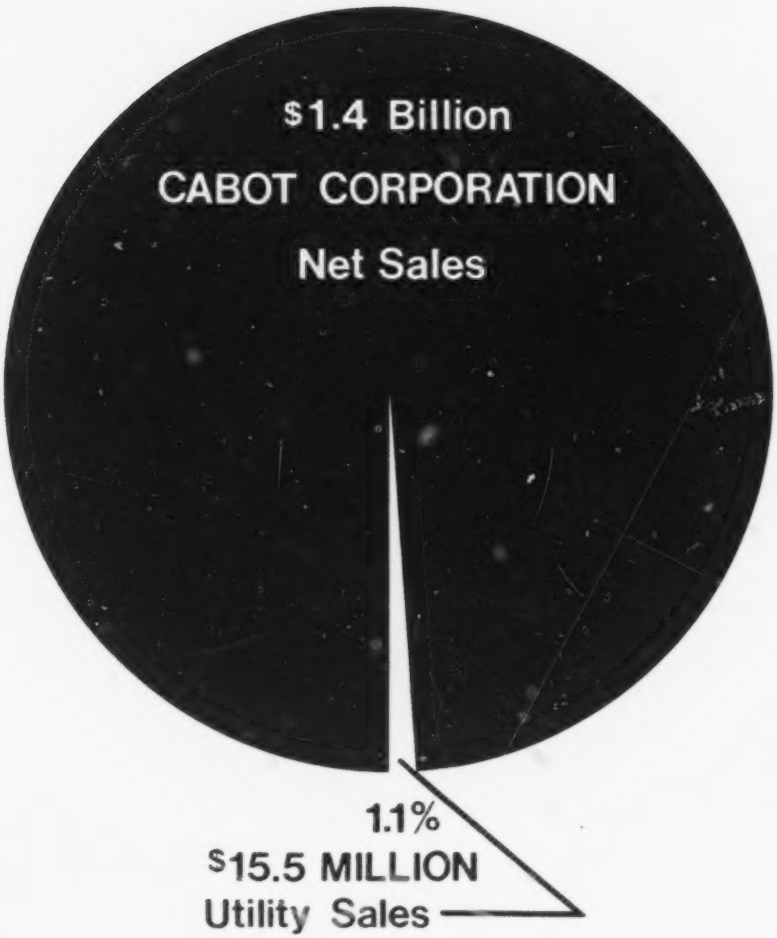

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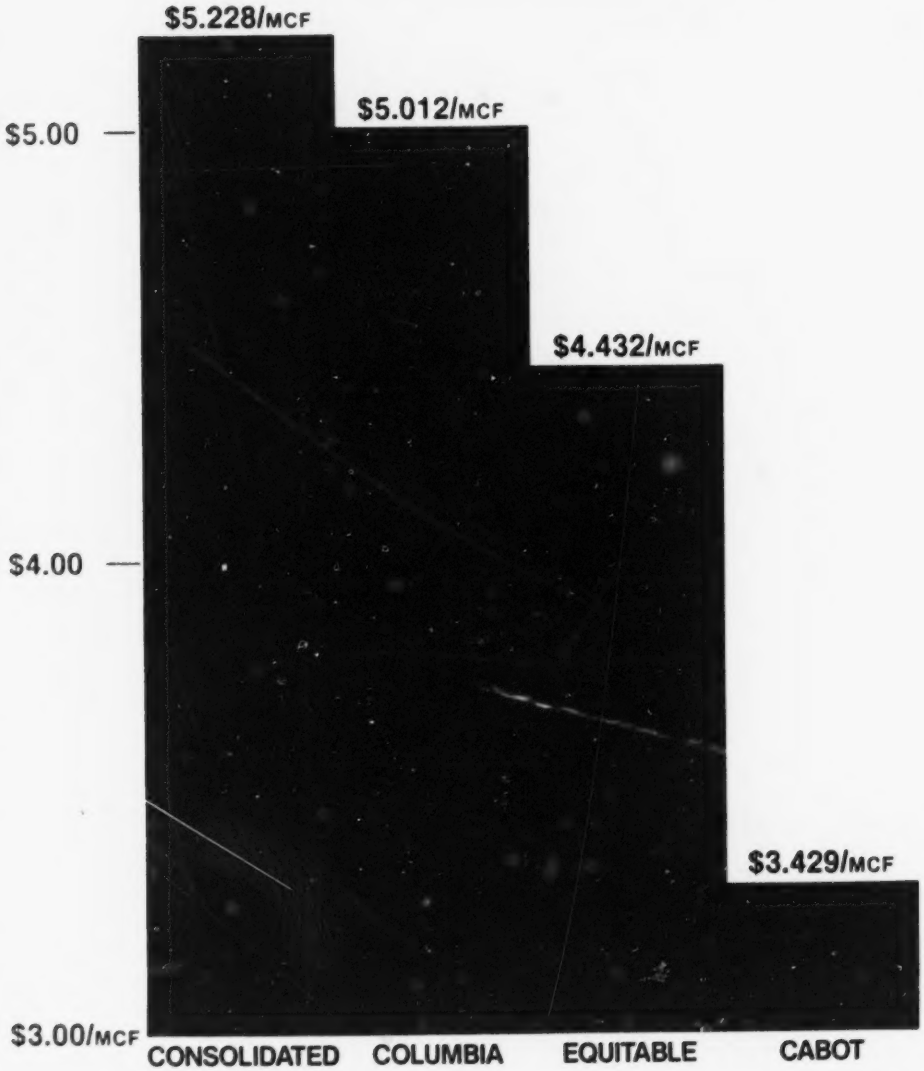
Chart 2

*AVERAGE PRICE FOR HOUSEHOLDS USING 12 MCF PER MONTH



*Based on pending rate cases effective November 1, 1981

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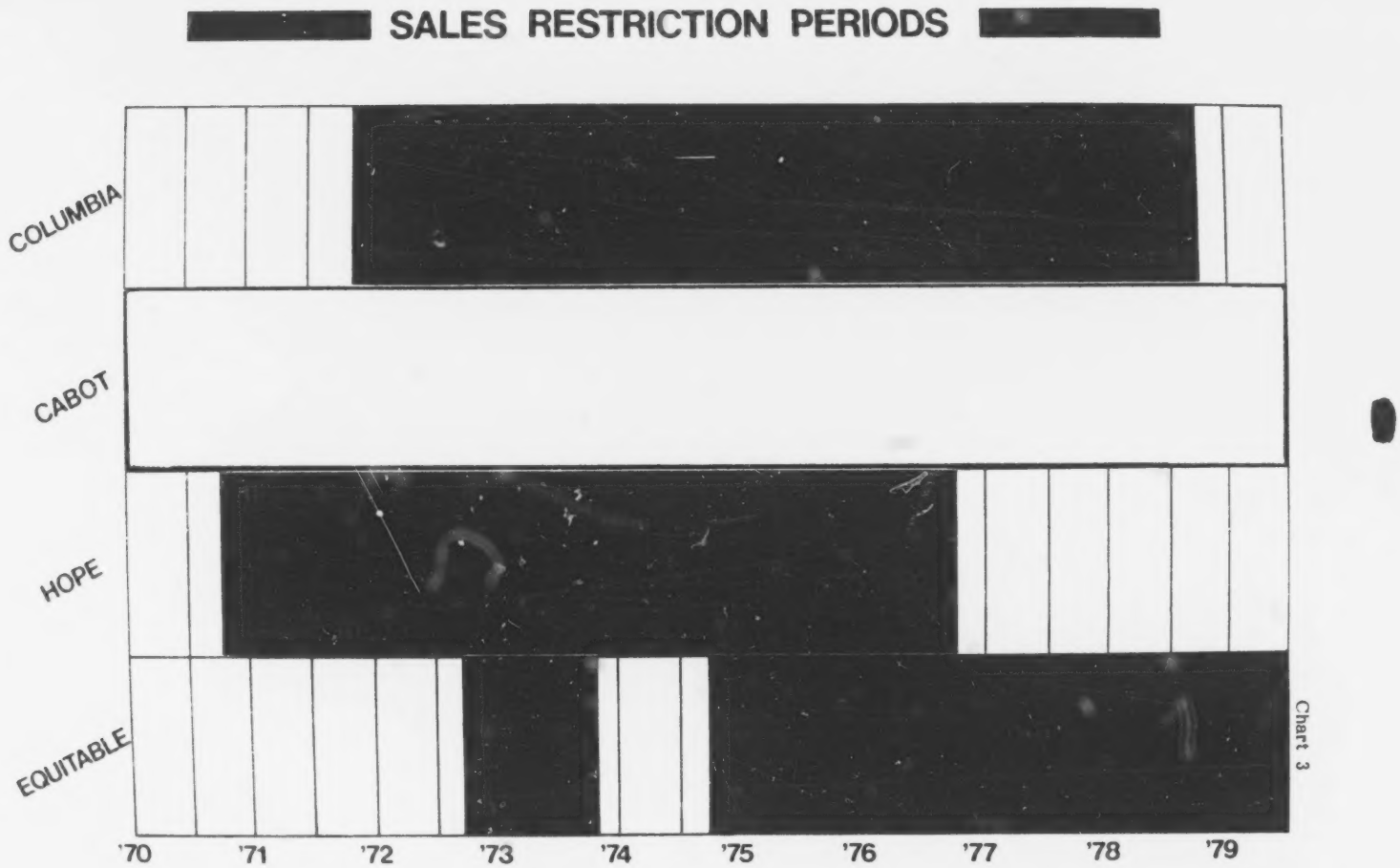

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ATTACHMENT 1

FINANCIAL PRACTICES AND INFORMATION DISCLOSURE

Some concern has been raised that reports filed under the Holding Company Act are in many cases the sole source of information required by state utility regulators to carry out their rate-making function. This is not correct. All public utility holding companies presently registered under the Holding Company Act also have securities registered under the Securities Exchange Act of 1934, which requires regular information disclosure by all companies which are listed on a national securities exchange or which have one million dollars in assets and 500 stockholders. In addition, all companies are subject to the Securities Act of 1933 when making a public distribution of securities. The disclosure systems of the Securities Act and the Exchange Act were just being developed when the Holding Company Act was adopted. Since that time, however, the scope and sophistication of these systems have grown enormously, going beyond the requirements envisioned for the Holding Company Act. For example, publicly held companies are required to disclose the revenues and profits from various segments of their business as well as the assets utilized in each segment. Comprehensive, audited financial statements must be furnished both in connection with securities offerings and on a regular basis, as well as information concerning the nature of a company's business, properties, management and capitalization.

The reporting requirements under the Holding Company Act and the Securities and Exchange Acts are largely repetitive. For example, we can find only two major differences in information required, comparing the annual report on Form U5S under the Holding Company Act and the periodic reports on Forms 10-K, 10-Q and 8-K under the Exchange Act. First, Form U5S requires a tabulation of political and public relations expenditures. Second, it requires a description of all service, sales and construction contracts between system companies (except contracts approved by the SEC under the Holding Company Act). Reports filed under both statutes include information regarding the acquisition or sale of assets, the issuance and retirement of securities, investments in utility and non-utility businesses, principal owership of holding company securities, management, material litigation and audited financial statements.

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The major difference between the reporting requirements under the two acts is that the Holding Company Act requires more detailed information. In light of this fact, the information requirements of state utility regulators could be met under the Exchange Act even if the Holding Company Act were repealed. Furthermore, if the Congress concluded that more detailed information were required about utility holding companies than about other companies, the SEC could use its authority under Section 19 of the Securities Act and Section 23 of the Exchange Act to establish special disclosure requirements by rule. For example, the SEC has adopted a special industry guide which requires oil and gas producing companies to provide special information about their businesses. A similar approach could be used to assure that the repeal or modification of the Holding Company Act would not result in a reduction of essential and useful information to investors and state utility regulators.

In addition, the world has changed a great deal since the Holding Company Act was passed in 1935. The standards of the investment community have become more sophisticated. Securities rating agencies (Moody's and Standard and Poor's) and investment banking analysts keep a careful watch over all major corporations. Clearly, rating services and investment firms sizeable enough to handle new stock offerings would shun holding companies with a financial structure like those which characterized utility holding companies prior to 1935.

Finally, there is far more effective and sophisticated state regulation today than in 1935. The state public utility commissions can eliminate the vast majority of improper financial practices which were common before 1935. Their review is intense and frequent. For example, Cabot's rates are regulated by the West Virginia PSC, and every disposition of any asset of the utility requires advance Commission approval.

ACCOUNTING PRACTICES

Under the Holding Company Act, the SEC has the power to impose a uniform system of accounts on registered companies. However, the SEC has so effectively exercised its broad powers under the Securities Act and the Securities Exchange Act to establish standards for Uniform System of Accounts that, in 1975, it decided a separate system under the Holding Company Act was unnecessary.

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Today, through Regulation S-X and nearly three hundred Accounting Series Releases, the SEC maintains accounting standards for all public companies.

Moreover, since the Holding Company Act was passed both the states and the federal government have adopted a uniform system of accounts for public utility companies pursuant to authority granted by other statutes. For example, the Federal Energy Regulatory Commission (FERC) has adopted a uniform system of accounts which all jurisdictional natural gas companies must follow, and the West Virginia PSC has adopted a uniform system of accounts based on the FERC model.

In 1935, the means of establishing and enforcing generalized accounting principles barely existed. Since then, the accounting profession has established an elaborate mechanism for the development of generally accepted accounting principles and an effective means of compelling adherence to them under the Financial Accounting Standards Board (FASB). All public companies are required by the Exchange Act and the rules thereunder to file with the SEC and to send to their shareholders financial statements reviewed by independent public accountants. In addition, section 13(b)(2) of the Exchange Act mandates a system of accurate recordkeeping and adequate internal controls.

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Mr. SWIFT. I thank the gentleman from Illinois.

The Chair would ask unanimous consent that there be placed in the record a statement submitted to the committee by the Environmental Action Foundation on its own behalf and on behalf of 11 other environmental organizations.

Hearing no objection, it is so ordered. [See p. 697.]

Mr. MOORHEAD. Mr. Chairman, may this statement be placed in the record?

Mr. SWIFT. Certainly. Would you care to have some time to speak?

Mr. MOORHEAD. I just wish to commend our chairman for calling these hearings today. Obviously the various public utilities are in serious financial condition, many of them, and they are plagued by all kinds of regulations, some of which may be good and some of them may not be, and I think it is our job to see that the regulations don't become the cause of the problem rather than a way to settle problems in this country, and for that reason I think these hearings will give us a good background from which we can form regulations that will perhaps alleviate some of the difficulties that the industry is now having.

Mr. SWIFT. Without objection, your entire statement will be placed in the record.

[The statement of Mr. Moorhead follows:]

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STATEMENT OF HONORABLE CARLOS J. MOORHEAD
BEFORE THE SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
HEARING ON AMENDING OR REPEALING
THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
JUNE 9, 1982

I WOULD LIKE TO WELCOME OUR WITNESSES HERE TODAY TO TESTIFY ON THREE BILLS BEFORE OUR SUBCOMMITTEE WHICH WOULD AMEND OR REPEAL THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (PUHCA). H.R. 6134, INTRODUCED BY MR. COLLINS, AND H.R. 5465, INTRODUCED BY MR. TAUZIN, WOULD REPEAL PUHCA IN ITS ENTIRETY; WHILE H.R. 5220, INTRODUCED BY MR. CORCORAN, WOULD SUBSTANTIALLY AMEND THE ACT.

PUHCA WAS ENACTED BY CONGRESS ALMOST 47 YEARS AGO TO GIVE THE SECURITIES AND EXCHANGE COMMISSION EXTRAORDINARY POWERS TO DIRECT THE FINANCIAL AFFAIRS OF PUBLIC UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES. THIS WAS DONE BECAUSE OF NUMEROUS UNDESIRABLE PRACTICES BY VAST HOLDING COMPANY SYSTEMS THAT, BY THE EARLY 1930'S, CONTROLLED OVER 80 PERCENT OF PRIVATELY GENERATED ELECTRICITY AND 80% OF THE NATURAL GAS TRANSPORTED IN INTERSTATE COMMERCE IN THE UNITED STATES.

YET, DESPITE THEIR SIZE, THESE HOLDING COMPANIES WERE VIRTUALLY UNREGULATED WHEN PUHCA WAS ENACTED. THE SEC WAS IN ITS INFANCY -- HAVING BEEN CREATED BY THE SECURITIES AND EXCHANGE ACT OF 1934 TO ADMINISTER THIS 1934 ACT, AS WELL AS THE SECURITIES ACT OF 1933. THE NATURAL GAS ACT, WHICH GAVE THE FEDERAL POWER COMMISSION, NOW KNOWN AS FERC, CONTROL OVER INTERSTATE NATURAL GAS COMPANIES,

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WAS NOT PASSED UNTIL 1938. AND THE STATES, AT THAT TIME IN OUR HISTORY, WERE EXTREMELY WEAK AND UNDEVELOPED AND INCAPABLE OF EXERTING ANY CONTROL OVER THESE INTERSTATE HOLDING COMPANIES.

TODAY, OUR SUBCOMMITTEE HOPES TO DISCOVER WHETHER OR NOT REGULATORY DEVELOPMENTS SINCE 1935 NOW MAKE PUHCA UNNECESSARY. HAS THE SEC ACCOMPLISHED THE OBJECTIVES OF PUCHA? ARE OTHER CURRENT REGULATIONS SUFFICIENT TO PROTECT THE RATEPAYERS AND INVESTORS IF PUHCA WAS REPEALED? IS THE SITUATION WHICH LED TO THE ENACTMENT OF PUHCA LIKELY TO OCCUR AGAIN?

HOWEVER THESE QUESTIONS ARE ANSWERED, IT IS CLEAR THAT THE UTILITIES, ARE IN BLEAK FINANCIAL SHAPE TODAY.

I THINK WE ALL RECOGNIZE THAT IT IS CONGRESS' RESPONSIBILITY TO ENSURE THAT FEDERAL REGULATIONS -- WHETHER ENACTED THIS YEAR OR 50 YEARS AGO -- ARE NOT CONTRIBUTING TO THIS PLIGHT. FOR THIS REASON, I APPLAUD THE CHAIRMAN'S POPULAR DECISION TO HOLD HEARINGS ON THESE BILLS; AND IF WE LEARN THAT THE REPEAL OR REFORM OF PUHCA CAN REMOVE BARRIERS TO RESTORING THE FINANCIAL HEALTH OF THE BELEAGUERED UTILITIES -- WITHOUT HARMING THE RATEPAYER OR INVESTOR -- I AM SURE WE CAN LOOK FORWARD TO PROMPT MARKUP ON THESE BILLS.

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Mr. SWIFT. Now to our panel. Mr. Guy W. Nichols, Mr. S. Kinnie Smith, Jr., Mr. Alan Richardson, and Mr. Scott Hempling.

If it is acceptable to the other members of the commmittee, I would like to follow a procedure by which we give each witness 5 minutes to make their presentation, and take all of the testimony before we ask questions.

I will ask unanimous consent that the prepared statements of all of the witnesses be included in full in the record, so that you can proceed as you wish with your 5 minutes, and we will begin with Guy W. Nichols, chairman, president, and chief executive officer of the New England Electric System, on behalf of the Edison Electric Institute. Mr. Nichols.

STATEMENTS OF GUY W. NICHOLS, PRESIDENT, NEW ENGLAND ELECTRIC SYSTEM, ON BEHALF OF EDISON ELECTRIC INSTITUTE; ALAN H. RICHARDSON, LEGISLATIVE DIRECTOR, AMERICAN PUBLIC POWER ASSOCIATION; S. KINNIE SMITH, JR., GENERAL COUNSEL, AMERICAN NATURAL RESOURCES CO., ON BEHALF OF AMERICAN GAS ASSOCIATION; JOHN KRULL, PRESIDENT, NASSAU COUNTY ASSOCIATION OF PLUMBING-HEATING-COOLING CONTRACTORS, ACCOMPANIED BY HAROLD KRAININ, COUNSEL; AND SCOTT HEMPLING, LEGISLATIVE REPRESENTATIVE, CITIZEN/LABOR ENERGY COALITION

Mr. NICHOLS. Thank you, Mr. Chairman. I am here today representing the registered holding company that I work for, the New England Electric System, as well as the Edison Electric Institute. With your permission, I would like to submit the testimony of Floyd Lewis, the chairman of Middle South Utilities, presented to the Senate Securities Committee, on this same subject on behalf of our industry. Together our written statements, I believe, properly depict the industry's position.

Mr. SWIFT. Without objection, it will be included in the record following your statement.

Mr. NICHOLS. Thank you very much.

I am here today to support total repeal of the act, because I think that total repeal favors the ratepayers as well as the investors and the employees of the registered holding companies. I also think that it is good energy policy to totally repeal the act.

Now, we don't recommend this because the act has been poorly administered in anyway by an inefficient bureaucracy, because this has not been the case. Rather, despite what I consider very intelligent administration by a good staff in the SEC, it is the act itself that imposes unnecessary costs on our industry and costs on our ratepayers without corresponding benefits.

I would also like to acknowledge the fact that when the act was drafted and passed, it had a purpose. That job has been done, and that job was to restructure the industry. At that point in time we had subholding company piled on top of subholding company, allowing a small investment on the top of the pyramid to control a huge amount of assets at the bottom, and no investor could intelligently make a decision as regards investment in that world. But that restructuring has been done, and it is now 1982. As one of our

panel members pointed out, the act is now a hindrance, not a help, to our much beleaguered electric utility industry.

As my first chart suggests, only about 21 percent of the energy that we sell in our investor-owned electric utility industry is sold by the nine registered electric companies. About 32 percent is sold by companies that operate as exempt holding companies largely within one State, and the balance is sold by companies that don't have the holding company structure.

I want to emphasize, however, that the entire industry lives in fear of the act, and our decisions are all affected by the act. For example, the exempt holding companies fear they will lose their exemption and come under the constraints of the act.

The operating companies that I think in many cases would like to operate under a holding company structure—and I believe a holding company structure would benefit their ratepayers—fear to do so for fear that they will come under the restrictions of the act.

If I could have the next chart.

The purpose of the act was in large part to protect investors, and that protection is now provided elsewhere. As this chart suggests, the act moved in three directions: The first is now duplicated by the Federal securities laws. The second is duplicated by the controls enforced by informed investors operating in today's very sophisticated securities market. And the third, the control of new issues, is no longer necessary when you consider today's professional accounting standards and today's regulation of the securities trading market.

Most importantly, let's look at it from the viewpoint of the ratepayers. If I may have the next chart. How will they fare if we repeal the act? I think the answer is without question they will fare very well, because in the first place, we can reduce our costs, and as the first item on this chart suggests, we can lower our financing costs because we will have greater flexibility in the timing of our financing issues.

Such flexibility is essential if we are going to take into account and take advantage of operating in today's fast changing financial markets. This flexibility is simply not available to 1935 act companies who have to comply with very time-consuming rules of the act and the regulations that have been established under that act.

Second, there is a definite cost related to missed business opportunties, because sometimes if you operate under the act, you just can't move fast enough to diversify into new business opportunities. If time permitted, I would like to tell you about the 14 months it took to get final approval from the SEC so that we could make the decision to construct the first coal-fired coal ship to be built in this country in many decades. But time does not permit it.

I think that repeal will also lessen the ratepayers' risk that will occur and has occurred when utilities diversify, and I want to emphasize they are diversifying with or without repeal. Nearly two-thirds of electric utilities in the country today are diversified to one degree or another. I think it will be much easier for the regulators of this country to properly identify the costs associated with diversified activities under a holding company structure, rather than having to try to identify those costs if the diversified operation is a Department within a single operating company. It is

much harder in the latter case. I think it is in the ratepayers' best interests to favor the holding company structure rather than to oppose it, for that reason.

The fifth point on that chart is one with which I am very familiar: A diversified operation permits a utility to attract and keep good people. I know this committee has strongly encouraged conservation and our industry supports that. By design we are trying to keep our growth rates down, and I ask you to think about the problems of trying to attract good people when you are operating a very low growth operation. You just can't do it. Diversified operations permit you to attract and get good people.

I am going to skip over the next two charts that address benefits to investors and the benefits to employees, because 5 minutes does not allow time for consideration of these subjects. I would like to go to the next chart concerning energy policy.

I believe that repeal is good energy policy for this country because repeal will free up the utilities to do a lot of things that I think you would like to see the utilities do. We have a good example in our own system. We have a management investment and operations company, now proposed to the SEC, whereby we will invest in commercial and industrial conservation devices on commercial and industrial properties. We will share the benefits of the energy savings that occur, 50-50 on an 8-year basis. That is a good type of business to be in, but we can't get into it until the SEC grants us the approval to go forward. We think that many businesses of that type—I am reminded, for example, that Puget Sound Power & Light has done a lot of good things in the area of conservation. There are a lot of things I expect they would like to do that they would hesitate to do now for fear of coming under the act.

In summary, if I may go to the last chart, I am convinced that the Public Utility Holding Company Act of 1935 is costly, unnecessary and discriminatory. It is costly because it takes the time and attention of utility management to meet duplicative regulatory requirements of the type that Mr. Collins referred to. It is costly because it limits flexibility in financing. It is costly because it ties down very capable people, including the SEC staff. It is costly because each of the registered holding companies has to spend roughly a half million in unnecesary dollars a year. It is unnecessary because the regulations have largely been duplicated elsewhere. And certainly, as one of the nine registered electric companies, I think it is discriminatory, because it is applied directly to only a very small part of an industry.

Thank you.

[Testimony resumes on p. 379.]

[The prepared statement and attachments of Mr. Nichols follow:]

Statement of

Guy W. Nichols
Chairman, President and Chief Executive Officer
of New England Electric System

on behalf of

The Edison Electric Institute

Mr. Chairman and members of the Subcommittee, my name is Guy W. Nichols. I am the Chief Executive Officer of the New England Electric System, a registered holding company regulated by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (Holding Company Act.)

I appear before you today on behalf of the Edison Electric Institute (EEI), an association whose membership is composed of substantially all of this country's investor-owned utility companies. These companies provide approximately 77 percent of the nation's electric service.

As you are aware, the SEC has unanimously concluded that the Holding Company Act has served its basic purpose and that "continued federal regulation of utility holding companies is unnecessary and inappropriate."[1/] The EEI concurs in that judgment and joins the SEC in asking the Congress to remove the regulatory burdens which continue to apply to important segments of our industry under this 47 year old statute.

My colleague, Floyd W. Lewis, Chairman and President of Middle South Utilities, very ably stated EEI's position before the Senate Securities Subcommittee on April 27, 1982. I respectfully request that the Subcommittee receive Mr. Lewis' statement (which I have appended to my testimony) into the record of these proceedings.

1/ Letter of Chairman John S.R. Shad to Senator Alfonse M. D'Amato (December 21, 1981).

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I have several reasons for making this request. It is not my intention merely to restate the points made by Mr. Lewis, using my own words.[2/] I do not think that would be very useful to the Subcommittee. Nor do I have confidence that I could improve on his articulation of the basic arguments in support of repeal of the Act. Instead, I would like to respond to a number of questions which I suspect are central to your deliberations.

Before I turn to that task, some preliminary comments are in order. This is not a case where the Congress is being asked to step in and restore reason to a regulatory agency which misperceives its public responsibilities. The SEC and its staff have done a highly commendable job in administering this statute. Their efforts deserve Congressional praise (an uncommon circumstance in these days of growing dissatisfication with the work of government). This agency has over the years earned the public's respect for professional competence and integrity. My comments today, though sometimes critical, should not detract in any way from the deserved high reputation of this Commission or its staff.

The Subcommittee will hear today from witnesses who will urge you to retain the Holding Company Act because of their concerns with the implications and consequences of utility

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2/ However, I am prepared to respond to any questions you may have with respect to Mr. Lewis' testimony.

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diversification. I would acknowledge that the present debate over utility diversification is related to the question whether the Act continues to serve a valid public purpose. But it should not be determinative of that question.

There are other issues involved. Some registered holding companies as well as a number of companies not subject to the Act which are supporting the repeal initiative have no present plans to pursue diversified business strategies. Their objective is only to see the segment of the industry regulated under the Act relieved of controls that have become tedious, costly, largely anachronistic and unnecessarily restrictive of management's ability to manage the financial affairs of the holding company system.

Moreover, it must be kept in mind that to maintain the Holding Company Act in its present form will not "prevent" utility diversification. Rather the primary consequence of continuing the Act unaltered is that it will constitute, in effect, an "implicit" public policy decision to discourage the use of a holding company structure to manage diversified activities and to slow the pace of diversification.

The Holding Company Act is not per se an anti-diversification statute as some have represented it to be. Its primary purpose was to equip the SEC with the means to restructure the complicated holding company pyramids which existed in the early part of this century and which served as

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vehicles for stock manipulation and self-dealing. Specialized federal controls over the reorganization of these companies were found to be necessary in the absence of effective securities regulation, and state or federal rate regulation.3/ The task of simplifying the holding company systems was completed almost three decades ago. The Act's direct supervisory controls over financial management and business acquisition today apply only to twelve registered holding companies (nine electric utility holding companies and three gas utility holding companies). Approximately 85 holding companies are exempt under the Act from direct supervision by the SEC of their business activities although, like registered companies, they are subject to a broad array of rate regulatory controls at both the federal and state level.

A recent survey of its members conducted under the sponsorship of EEI reveals that almost two-thirds of the electric utility industry is diversified to some degree into non-utility business activities. Included in this universe are registered holding companies as well as exempt holding

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3/ When the Holding Company Act was passed only 22 states regulated utility rates; there was at that time no regulation of interstate sales or transmissions of electric energy. Indeed, Titles II and III of the bill which became the Holding Company Act reposed federal rate regulatory authority in the Federal Power Commission and established uniform accounting controls. Moreover, the investor protections provided in the federal securities laws were only newly established. The Securities Act of 1933 and the Securities Exchange Act of 1934 were in the early stages of implementation.

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companies and operating utilities which have not adopted a holding company structure. Registered holding companies have confined their activities, as they must under the constraints imposed by administrative and judicial interpretation of the Act, to functionally related enterprises, principally fuels supply and associated transportation. Exempt holding companies and non-holding company utilities are not so restricted. Nevertheless, the broad administrative latitude which resides in the SEC to condition or withdraw exempt holding company status exerts an indirect influence on diversified activity on the exempt companies.[4/] The nature and extent of controls of diversified activity by non-holding company utilities is singularly a question of state law.

Thus, as the electric utility industry is presently structured, roughly 20 percent of the industry is subject to direct limitation and supervision of diversified business activity by the SEC under the Holding Company Act (i.e. the registered companies); another 20 percent is potentially subject to indirect supervision (i.e. the exempt holding companies); and the remainder is free from federal controls in this respect.

4/ The SEC has enunciated guidelines for its tolerance of diversified activity by exempt holding companies in two leading cases handed down in the early '70's. In re Pacific Lighting Corporation, SEC Holding Co. Act Release No. 17,855 (January 11, 1973); In re National Utilities & Industrial Corp., 45 SEC 167 (1973).

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The Holding Company Act is one of the most comprehensive mechanisms of economic regulation to emerge from the New Deal era. Quite literally, registered holding company management can make no decision of importance without first obtaining the SEC's prior permission. Consequently, the Holding Company Act serves as a meaningful constraint on the use of a holding company structure to manage diversified activities. Hence, the real question involved in the present debate over retention or repeal of the Holding Company Act as it relates to utility diversification is not directly "whether utility diversification is good or bad from a ratepayer or public policy perspective", but "whether the use of a holding company structure to manage such activities should be discouraged." Because that is precisely the effect of the Act today.5/

With this background in mind, it would seem to me that the pivotal questions in evaluating the implications of repeal of the Act are:

(1) How does the choice of corporate structure affect the interests of shareholders, investors and regulators?

(2) Would repeal of the Holding Company Act remove regulatory constraints which are today still

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5/ Indeed most will acknowledge that this is the only practical effect of the Act's administration inasmuch as the investor and ratepayer protections have been superseded by the development of rate regulatory or traditional securities controls.

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important to (i) the safeguarding of investors interests, or (ii) the protection of ratepayers?

(3) If the Act were to be repealed, how might ratepayers and investors be advantaged?

It is my intention to deal with each of these questions in the order in which I have presented them. I recognize that each question involves a number of sub-issues and that the Subcommittee may have in mind other questions which they believe to be material to the issues at hand. I would be pleased, therefore, to attempt to supplement the record by submitting written response to any additional questions you may have.

Let me turn now to the first of the questions:

<u>How does the choice of corporate structure affect the interests of shareholders, investors and regulators?</u>

As I previously noted, a utility may diversify (and many have) by managing the non-utility enterprise as a separate department within the utility itself or by creating a wholly-owned subsidiary for this purpose. Alternatively, a utility may choose a holding company structure.

Let us first assume that the diversified enterprise is conducted as a separate division of the electric utility. This form would seem to maximize the risks to ratepayers if something goes wrong. Creditors of the diversified business would be able to call upon the assets of the utility in the

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event of business failure and losses would be borne by the utility. Rate regulatory commissions would find it difficult to insulate ratepayers fully from the consequences of business failure. Moreover, whether or not diversification is successful, regulatory problems with cross-subsidization and cost allocation would seem to be compounded if diversified activities are managed through a division of the utility. Ultimately the rate regulatory commissions at both the state and federal level would have to develop requirements for recordkeeping and accounts which will permit them to compute and assign costs and risks to the diversified activity. This is not an impossible task. Rate regulatory commissions already have considerable experience in this area. But the point is that it is a task made more complicated by the failure to isolate those factors through the use of a separate corporate entity. From the rate regulator's standpoint, therefore, the use of a separate division of the utility requires the highest degree of regulatory control.

If a subsidiary of the utility is formed to manage the diversified business activity, the rate regulatory problems are somewhat simplified, particularly if separate management personnel are employed by the utility to manage the subsidiary. Also the risk exposure to the utility could be confined to its equity interest in the subsidiary. But some direct liability for the diversified business would persist. Direct regulatory

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control of the parent utility would be sufficient to assure regulatory control of the subsidiary.

From the investors' standpoint this case is much like that which occurs when a separate division manages the diversified venture. There is for the shareholder some risk that the entirety of the benefits of profitable diversification will be distributed to ratepayers while the losses, should they occur, may be entirely assigned to the stockholders. This potential, should it materialize in rate regulatory practice, discourages investment and may influence management to forego opportunities which may be mutually beneficial to ratepayers and investors. The use of a separate corporate entity helps in the accounting of such benefits and risks and thus gives the stockholder some basis for resisting a cross-subsidization of the utility business, but the protection is not substantial.

If, on the other hand, a holding company structure is adopted, investors might gain greater confidence in their ability to protect the fruits (i.e., profits) of their risk-taking. Similarly the ratepayer would enjoy maximum insulation from the tarnished fruit (i.e., losses) of the diversified activity. Rate regulatory authorities in certain jurisdictions may encounter limitations on their ability to assert control over the consolidated enterprise.6/

6/ We believe, however, it can be demonstrated that any such diminution does not prevent a commission from carrying out its rate regulatory responsibilities. In any case, rate regulatory

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Hence, it appears there is a corresponding relationship among the interests of shareholders, ratepayers and regulators depending on the corporate structure employed to conduct diversified business activities. The need for regulatory control and risks to ratepayers are at their highest level, when diversified business is managed through a separate division of the utility. The need for regulatory control and risks to ratepayers are at their lowest if a holding company structure is employed. The use of a corporate subsidiary of the utility places those interests somewhere in between.

A ratepayer anxious to minimize its exposure to loss from diversified business investments logically should opt for the holding company structure. So should the investor motivated by the desire to insulate and recover the benefits of his risk-taking. The regulator should have no objection provided he or she is able to continue to assure that the utility satisfies its service obligation and ratepayers are not asked to pay costs which are not properly their responsibility. Hence it would seem that the critical public policy question involved in the use of a holding company structure is whether the diminution in control is such that the rate regulatory authority cannot confidently perform its obligation to protect

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commissions live with this circumstance with no apparent difficulty in the case of exempt holding companies.

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ratepayers from unreasonable costs and to assure adequate and reliable electric service. In my view the powers traditionally exercised by state and federal rate regulatory authorities are adequate to those purposes.

We have attached for the Subcommittee's consideration as Appendix A, a fairly comprehensive review prepared by EEI's Office of General Counsel which surveys the "Effect of State Laws and Regulations on Utility Diversification." This review candidly acknowledges that "there are no definitive legal answers equally applicable to all states . . . [concerning] the effect of state laws and regulatory practices on utility diversification activities. State laws, regulatory practices and regulatory climates vary with each jurisdiction. Many of the relevant statutes are extremely vague and are susceptible to a variety of interpretations." On the other hand, what should come through as clear to the reader are the following points which we believe to be particularly relevant to the issue at hand:

(1) States possess considerable sovereign authority to regulate utility diversification if they so choose. A number of statutes have been passed which are unassailed and unchallenged as to their constitutional foundation. Those questions which have arisen involve matters of statutory scope and interpretation.

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(2) Regulatory agencies at the state level have proved to be particularly adept at protecting ratepayers from incurring unreasonable costs attributable to diversified enterprise. Indeed the great majority of the instances in which the courts have reined in the regulatory agencies involved circumstances where the commissions appear to go too far in seeking inappropriately to assign to ratepayers the benefits from non-utility business activities where there has been no corresponding ratepayer financial contribution or responsibility for the risks.

(3) Policy and regulatory concerns with utility diversification have been around for some time. There is already a considerable (albeit somewhat uneven) history and a regulatory practice for dealing with such issues. Several of these cases involve holding companies. No case law has been uncovered that suggests the state commission's regulatory powers differ markedly depending on what corporate structure is employed to manage diversified activities.

(4) Generally state commissions have found themselves able to get needed access to books and records and to prescribe accounting requirements incidental to the exercise of their rate regulatory responsibilities.

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Where state statutes failed to specifically provide the authority, the courts have implied it.

In examining this document, the Subcommittee should keep in mind the rate regulatory commission's most fundamental power and most flexible tool for shaping utility management attitudes and activities: the control over the rate of return. And if this device should ever prove to be inadequate, state authorities can resort to more drastic powers.

The utilities' obligation to serve is well rooted in the common law. A number of states have memorialized this obligation in statute as a condition of the franchise license. In rare instances, state commissions have moved to withdraw a recalcitrant or miscreant utility's franchise, restricted dividend payments, or threatened injunctive action or even imprisionment. Significantly, none of these cases have involved electric utilities. There may be problems with this industry, but disregard for the utility's obligation to provide adequate and reliable service has not been one of them. Nor does anyone seriously suggest that it will become a problem in the future.

Let me now turn to what is perhaps the most fundamental question involved in your consideration of whether to repeal the Holding Company Act.

Would repeal of the Holding Company Act remove regulatory constraints which are today still important to (i) the safeguarding of investors' interest or (ii) the protection of ratepayers?

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Safeguarding of investors' interests

Investor protection is intended to be secured under the Holding Company Act by the requirement that the SEC approve the terms of any financial transaction of significance, including the sale of securities to the public.7/ Registered companies (of which but twelve remain) are the only entities required to obtain the SEC's prior permission to sell stock or incur indebtedness. The SEC dispenses this permission on the basis of what it perceives to be sound financial management.8/ Investor protection for all others is achieved by the continuous disclosure system contained in the Securities Exchange Act of 1934 ('34 Act) and the stock registration requirements and accounting standards administered under the Securities Act of 1933 ('33 Act). Registered holding companies must comply with these requirements as well.

Under the Holding Company Act there are three avenues available to protect investor interests: the authority to

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7/ The procedures for review of securities issues and assumptions of liability are also aimed at certain purposes of consumer protection, e.g., the protection of utility assets. The SEC's powers are plenary and its authority to direct holding company financing enables the Commission to address a broad range of public purposes. However, the SEC's administration of these powers has traditionally focused on controlling capital structures of registered companies "in the name of investor protection".

8/ And, in many important respects, the concepts of what constitutes sound financial management remain rooted in SEC policy statements issued in the mid-'50's.

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require public reporting of the systems' financing, capital structure and related matters; the authority to require that these reports comply with uniform accounting standards; and the authority to control the substance of securities issues, including redemptive provisions, voting privileges, the amount of stock to be issued and the terms of its sale or placement (i.e. competitive bidding versus negotiated sale or placement). These first two categories of authorities -- reporting requirements and accounting standards -- are unnecessary because they are substantially duplicated in the federal securities laws which apply to all publicly traded corporations, and by professional standards. The third category of controls, although not duplicated elsewhere, is nevertheless also unnecessary. The simple and inescapable point is that the investor protections afforded under the modern administration of the securities laws coupled with the development of professional accounting standards and regulation of the trading markets have eclipsed the investor protection sought to be achieved under the Holding Company Act.

It must be kept continually in mind that exempt holding companies are not similarily subject to these specialized controls. Nor are non-holding company utilities. They must comply only with the '33 Act and the '34 Act and either state commission or FERC controls on public utility companies. Yet it cannot be seriously claimed that investors in these

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companies are exposed to greater risks than investors in registered companies. We know of no empirical evidence that would demonstrate the point. Nor is this a question of size. Many exempt holding companies are many times larger than registered companies. The critical distinction is that registered holding companies are engaged in utility operations in more than one state, while the utility operations of exempt companies are substantially confined to a single state. How is the investor in the securities of a holding company any worse- or better-off if the utility operations are multi-state?

There are yet other reasons for removing these specialized securities clearance requirements. Because not only are these controls unnecessary, they also sometimes add to capital costs. First, there are the problems of regulatory lag. The average time for review of an ordinary securities transaction is sixty days. During this time, the securitites markets can change and advantageous circumstances -- such as a break in interest rates or a good market for the company's common stock -- may evaporate. Careful management can help to minimize these effects and in some cases contemporaneous review by state authorities may extend the delays beyond even that caused by the SEC. However, it is not infrequent that the time necessary for SEC review can force a company to bypass attractive opportunities to enter the securities markets to raise capital for its utility business.

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The problem may be particularly acute, when a company must lay before the SEC a request to increase its short-term borrowing limits. For example, an unexpected outage of generation can rapidly escalate the cost of short-term debt. Such volatility cannot be "planned for" and regulatory delays in approving additional borrowings may impose significant interest penalties on the utility and its ratepayers.

Far more onerous than regulatory lag, however, is the burden of substantive restrictions on securities issues, such as the Commission's 1950's policy statements on first mortgage bonds and on preferred stock, and its strictly enforced requirement that registered companies select securities underwriters through competitive bidding. These problems are well developed in the testimony presented by Floyd Lewis and I will not attempt to repeat the points made so effectively in his presentation. However, I do want to underscore Mr. Lewis' point that the SEC's policies are rooted in historical concerns which are frequently not at work in today's trading markets. For example, the policy statement on first mortgage bonds requires certain redemption provisions for sinking and improvement funds. When a Florida utility used such a provision to redeem bonds otherwise subject to a no-call restriction, the market responded by, in effect, attaching a penalty to the inclusion of such redemptive provisions in future issues. Unregulated utilities can respond t this,

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simply by eliminating such provisions. Registered companies cannot.

Lastly, I should make some mention of the costs of compliance. The direct costs are primarily those associated with the commitment of staff time and other resources necessary to meet the periodic filing requirements (such as Annual Report U-5-S) and the filing requirements under section 7 of the Act in connection with the SEC's review of securities issuances. While company costs vary depending upon how frequently a particular company may need to access the capital markets, it appears that most registered companies absorb direct costs of between 400,000 to 600,000 per year. And these are conservative estimates. Associated legal costs would be additive. Moreover, no attempt has been made to assign a portion of costs attributable to the time spent by senior management on Holding Company Act matters.

These figures may not seem very impressive to you. Nor are you likely to be impressed with the savings to be achieved in the SEC's budget if these functions were eliminated. Yet neither the taxpayer nor the registered companies and their ratepayers should be asked to continue to pay even relatively modest amounts (although measured in several million dollars per year) for a system of controls that yields no discernible benefit.

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Protection of Ratepayers

There are some claimed consumer protections under the Act which should be examined as the subcommittee contemplates its repeal or amendment. Judging by the testimony presented before the Senate Securities Subcommittee, some consumer groups are opposed to repeal because they are concerned that losses due to reverses in the non-utility businesses will impair the ability of management to raise capital necessary to provide reasonably priced utility service. Also, because repeal of the Act would eliminate the SEC's authority to review affiliate transfer prices and cost allocations, a question has been raised whether state and FERC rate regulation is adequate to prevent interlocking management of utility purchasers and non-utility suppliers from passing through excessive charges to customers.

I should emphasize first that these questions are not of equal weight. Affiliate transfer pricing and cost allocation are legitimate questions of utility rate regulation and the Committee should properly be concerned whether the elimination of the SEC's authority creates a regulatory gap that cannot be bridged by state or federal rate regulation. (We believe it does not.) However, with respect to the question of consumer protections against diversified business losses, I would contend that the concern is much overstated, and that even in the event of such loss, any perceived protection to be gained from the Holding Company Act is illusory.

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Contained in Appendix B to my testimony is a chart prepared for EEI which demonstrates that two factors must be present before diversification presents any risk to ratepayers. First, a utility would have to diversify substantially before business reverses would impair the earnings of the utility, thereby affecting its position in the capital markets. Second, these non-utility businesses would have to suffer significant losses, perhaps even total project failure, before it could measurably affect the utility side of the firm's earnings. Yet the record shows that we are very far from approaching either of those circumstances. Few electric utilities have deployed more than 10 percent of their assets in diversified ventures. And, perhaps more importantly, the experience thus far shows many measurable successes in electric utility diversification and no significant failures.

Nevertheless, failure is not impossible, and it may be argued that SEC review imposes prophylactic limits on the pace and extent of diversification, and thus on the degree of loss. But the incremental pace of utility diversification is much more the product of marketplace disciplines than it is of SEC control.

The capital poor position of utilities precludes the hasty pursuit of an ambitious diversification strategy. If an initial step proves successful, the earnings produced and management and shareholder confidence gained will provide the

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basis for an expanded venture. This may lead to more substantial diversification and improved overall earnings. However, if things go poorly in the beginning or at some later time when further investments are planned to take place, retrenchment unaided by regulatory guidance is apt to occur. Moreover, there is simply no reason for customers to repose greater faith in the wisdom of the SEC than in that of management in assessing the risks and benefits of a particular diversified enterprise. The SEC staff brings to its review of non-utility investment no special insights or knowledge of business planning and management. In the absence of SEC controls, diversification undertaken wholly at the discretion of management will proceed within very substantial limits set by the nature of their own resources and the prospects for business success.

As I've suggested, we give greater credence to customer concerns with respect to affiliate transactions. These concerns are legitimate in one essential respect: it is true that there exists a regulatory responsibility to insure that shared costs are properly allocated and that shared management does not charge the utility unreasonable costs for goods and services, to be passed through to customers. It is our view however that the SEC, working within the confines of the "cost standard" of the Holding Company Act, is neither the pre-eminent nor the appropriate forum for resolution of these issues.

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At the time of enactment of the Holding Company Act, only twenty-two states regulated electric utilities rates and service. There was no regulation of interstate sales or transmissions of electricity.9/ The utilities did not keep standard books and accounts. Therefore, the drafters of the Holding Company Act assumed federal authority over transactions between associated companies in the same holding company system. They required that all transactions be priced at cost which the SEC interprets as cost plus a regulated rate of return. Unless an exception is granted in unusual (and rare) circumstances, the non-utility is typically allowed to earn only the utility rate of return set by FERC for the company's wholesale sales of electricity. And even profits from third-party transactions ordinarily are "recaptured" and credited to associated utility companies to subsidize the cost of goods and services they secure from their non-utility associates.

The statutorily imposed inflexibility of the cost standard operates in marked contrast to the broad latitude granted to FERC to set "just and reasonable" rates under the Federal Power Act. There are meaningful advantages to this more flexible ratemaking standard, which is also employed as a principle governing state rate regulation. Rate regulators may select

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9/ As previously noted, the Federal Power Commission (now the Federal Energy Regulatory Commission) was granted that authority in Title II of the bill that became the Holding Company Act.

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among a variety of pricing methodologies in regulating affiliate transfer prices to accomplish any number of regulatory objectives. For example, to encourage interstate pipelines to develop a more certain gas supply, the FERC in the 1960's eliminated the use of utility cost-of-service pricing for the pipelines' own gas production, and permitted them to collect the same rate designed to encourage independent gas production.

This latitude may be particularly significant with respect to electric utilities which have substantially diversified into fuel supplies, particularly coal. In Public Service Co. of New Mexico, the FERC recently rejected the use of cost-plus pricing for captive coal, in part because of its potentially adverse impact on customers. The FERC found it inappropriate to permit utilities to develop coal reserves free of the market constraints of competitive prices finding that there may be incentives to inefficiency inherent in applying cost-plus transfer pricing to non-utility ventures.

Moreover, although we look forward to passing on to our customers the benefits of cost savings, we believe that investors who bear the risk of diversified ventures are entitled to the profits from that investment.[10/] We therefore

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10/ Perhaps the best method for accomplishing this is the use of a market-referenced price such as that used by FERC and several states. However, other states faced with difficulties in determining a market for comparison, have attempted to set a return on non-utility investment relative to its risk. Either

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strenuously object that the cost standard denies us the opportunity available to other utilities to make that case to the rate commissions.

Certainly, the benefits of regulatory flexibility would not be persuasive if it were the case that rate regulators of today still lacked the authority to resolve transfer pricing issues. However, this is clearly not the case. FERC frequently has used its auditing authority to investigate transfer pricing. Many states have affiliate transaction statutes that empower rate regulatory commissions to approve the terms of affiliate company contracts. In most cases, judicial opinion and rate regulatory practice now support state commission investigation of non-jurisdictional affiliate accounts pertaining to transactions with the regulated utility and, most states are required by law to give such transactions special scrutiny.11/

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of these methods accomplishes a more just result than the cost standard.

11/ A related concern is the issue of cross-subsidization of non-utility businesses by improper cost allocation. While it is true that the SEC prescribes accounting standards for allocating shared costs among associate companies, (this task has been primarily the responsibility of rate regulators). The FERC has for years regulated diversified pipelines and found little trouble in allocating costs, including costs of capital for purposes of setting allowed rates of return. States, too, have experience with these issues in their regulation of diversified electric and gas utilities and telephone holding companies. The point is that cost allocation presents problems of methodology, not of authority. Were they the latter, it

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I would like to address one final question which may be raised in these proceedings. Concern has been expressed that elimination of the SEC's authority over acquisitions and dispositions of utility securities are an invitation to takeovers and, perhaps, the re-creation of holding company pyramids.

I assume that the Committee's primary concern here is not with electric utilities whose poor financial condition makes takeover unlikely, but with gas companies holding attractive reserve properties. However, with respect to electric companies, even in the absence of the Act other significant impediments to takeovers remain under section 203 of the Federal Power Act (FPA). A direct acquisition of public utility assets would require approval of either the FERC or the forty-five state agencies which administer similar constraints. And if the Holding Company Act were repealed, section 204 of the FPA requires FERC to approve securities issues, if no state authority is otherwise controlling. Many states do assert such authority, through "little holding company acts" such as that in the Connecticut statutes or by requiring approval of any change in control by a utility which holds a franchise license.12/

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would be understandable that Congress should be wary. However, the former are soluble and are the province of rate regulators.

12/ In addition to effecting control over utility acquisitions, states have used this authority to review

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I cannot claim that we have examined the laws of fifty states and can assure the Committee that in every case state authorities lie ready to fill any gap left by repeal of the Act. But I do know that existing state law is substantial and adequate to meet a great many situations. Perhaps more important is that any deficiency in the scope of state authority is statutory not constitutional. If regulatory gaps are discovered and public policy dictates they be closed, legislatures are fully empowered to do so.

However, the Committee should recognize that even if repeal of the Act resulted in some changes in utility ownership, it does not follow that the Act's retention is necessary to prevent the re-creation of holding company pyramids such as existed in 1935. Although this spectre may haunt this Committee's reconsideration of the Act designed to cure their "evils," the past simply cannot be recaptured. Too much has changed. It is hard to imagine that any group of investors could amass the capital necessary to bring under common ownership significant portions of the electric utility industry. The modern securities markets and the SEC would detect widespread abusive investment practices such as

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corporate reorganization for the purpose of diversification and to set limits on the nature and extent of diversification through conditions of the franchise.

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manipulation of voting privileges long before even the most intricate ownership schemes could transform utility capital structures into the highly leveraged pyramids of the past. Indeed their very intricacies would raise the doubts of analysts, brokers, accountants ang sophisticated institutional investors who could effectively preclude any profitable entry into the trading markets of a company which, for example, misrepresented its assets. And, rate regulatory authority exists to insure that holding companies may not drain the utility's revenue stream to finance these structures. For these reasons we are confident that repeal of the Act simply accomplishes the elimination of unnecessary regulation, in recognition of the fact that well developed utility and securities regulation are adequate to accomplish the purposes of effective utility holding company regulation.

I would like to now address the last of the three questions which I posed at the outset.

<u>If the Act were to be repealed, how might ratepayers and investors be advantaged?</u>

The first advantage in securing repeal of the Holding Company Act lies in the relief obtained from the unnecessary and sometimes costly financial controls applicable to registered holding companies. This has already been discussed in response to question two.

The second advantage is related to my discussion of the relationships between the interests of ratepayers, investors

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and regulators in the choice of corporate structure to manage diversified business activities. If the Act were to be repealed, the use of a holding company structure to manage utility and non-utility business would be a much more attractive alternative than it is today. And, as previously stated, it would seem that a holding company structure would minimize ratepayer risks from diversified enterprise and maximize the likelihood that investors would be assigned the benefits and losses which correspond to their risk taking. These effects also make diversification more attractive to utility management, thus increasing the likelihood that management will maximize economies of scale and capacity utilization to the advantage of both its stockholders and its ratepayers. Indeed, it would seem to me that sensible public policy should encourage the use of a holding company structure to manage diversified activities rather than discourage the use of this structure by maintaining in place unaltered an Act which imposes such a high regulatory burden of risk on an entity which would choose to manage its affairs by organizing a holding company.

Inevitably and unavoidably the discussion of the advantages to ratepayers and investors resulting from repeal of the Act turns to a consideration of benefits of utility diversification. This issue has been the subject of a recent study conducted by the Cabot Consulting Group and has been

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addressed in testimony prepared by several participants in proceedings conducted by NARUC's Ad Hoc Committee on Utility Diversification. Professional opinion appears to be in agreement on several points which I commend to the Subcommittee's consideration:

(1) Diversification, a commonly employed tool used by unregulated management to diminish business risk and thereby lower capital costs, offers the same benefits to regulated utilities. The NARUC Ad Hoc Committee's Draft Report has raised the counter-argument that diversification of risk may be better accomplished by diversification of an individual investor's portfolio. Even if this were true as a matter of investment portfolio management, the point cannot support a public policy judgment that utilities should be barred from diversified business ventures.[13/] Such a prohibition would deny ratepayers the benefits of decreased cost of capital attributable to diminished risk. As one utility analyst points out: "An electric utility has a

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13/ It should also be noted that even from the perspective of individual investors, portfolio diversification is not always the most attractive option. Charles A. Benore, a utility analyst for Paine Webber Mitchell Hutchins, Inc. has testified that in his professional view, diversified utilities on the whole are more attractive investments than utilities whose operations are confined to the traditional electricity generation, transmission and distribution business.

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distinct financial profile. During heavy construction periods, it throws off tax benefits, and absorbs cash. . . . Financial synergy can arise from diversification into a business with a complementary financial profile: cash generating, able to utilize tax shelter, and perhaps with a cyclical earnings pattern . . ."[14/] By permitting the utility to shape its profile to take advantage of these synergies, the benefits of lower capital costs through diversification can benefit ratepayers as well as investors.

(2) The Cabot study points out that utility diversification into counter-cyclical lines of business, such as fuel supply, tends to stabilize overall earnings, lowering the firm's cost of capital, with consequent costs savings inuring to the benefit of ratepayers. The Cabot study also demonstrates the point, strongly endorsed by utility analysts,[15/] that the ratepayer savings also arise from the "synergistic" application of excess utility assets or untapped managerial skills to the diversified business.

14/ Testimony of John W. Barr, Morgan Stanley & Co., Inc., before the NARUC Ad Hoc Committee on Utility Diversification (May 6, 1982).

15/ Id.

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(3) Most utilities lack both the desire or necessary capital to deploy significant portions of their assets into non-utility businesses. However, a recent Merrill Lynch study demonstrates that even a modest diversification strategy can better the utility's position in the capital markets. Examining 98 diversified utilities, only five of which derived 10% or more of their net income from diversified activities, Merrill Lynch found that "the market-to-book ratio for these companies was 67 percent higher than for other electric companies, with the market paying a premium both for the diversification per se and for the higher return on equity resulting from the diversification."16/

As these analyses demonstrate, diversification can better the position of shareholders and capture measurable direct savings for utility customers. Also of significance to customers is the potential benefit of diversification to the utility business, in the form of improved capability of utility management. Customers are fundamentally dependent upon the ability of management to skillfully steer the utility companies through their current financial difficulties. Diversification provides an opportunity to tone and enhance management

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16/ Testimony of Carl H. Seligson, Merrill Lynch, before the NARUC Ad Hoc Committee on Utility Diversification (May 6, 1982).

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capability. In some cases, business planning techniques learned in unregulated markets may be effectively adapted to the utility business to lower costs or improve service. In addition, the opportunity for greater mobility within a firm can attract new talent to the utility business.

These enumerated benefits from diversification commend the diversification option to many utility managers as one element in an overall corporate plan to strengthen the financial condition of a utility company or system. To the extent that the Holding Company Act serves as a bar to the realization of these benefits, it should be removed.

Before leaving this matter, I am compelled to re-emphasize the point made earlier: EEI's support for the repeal of the Holding Company Act is not dependent on the benefits of utility diversification. Several members of the industry would tell you most emphatically that they have no plans to diversify. Nevertheless they believe the regulatory burdens of this Act should be lifted and that utility management should be free to choose a holding company structure to manage diversified strategies which they may conclude are in their individual corporate interest. Others are more certain that utility diversification offers an important avenue to improve on their current financial and managerial difficulties. But they too would join in advising that utility diversification will not save the industry. Substantial improvement is and will remain

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uniquely dependent upon improvements in the performance of utility rate commissions and in consistently good management of the utility function.

Conclusion

Mr. Chairman, and members of the Subcommittee, I hope this discussion has proved to be useful. In my opinion, the case for repeal of the Holding Company Act is strong. It seems to be countervailed only by vague concerns which upon examination do not appear to have much substance. I would ask the Subcommittee to give considerable weight to the unanimous opinion of the SEC that this Act has served its basic purpose and that continued federal regulation of holding companies is neither desirable or appropriate. And if the Subcommittee is inclined to leave this 47 year old statute on the books I would respectfully request that you clearly articulate the public policy reasons for doing so and that you may consider whether there are more sensible, less burdensome ways of accomplishing those purposes.

Thank you for your courteous attention. I will be pleased to attempt to respond to your questions.

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Statement by -

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on behalf of
Edison Electric Institute
Favoring
Repeal of the Public Utility Holding Company Act of 1935
April 27, 1982

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you in support of S. 1977, Senator Johnston's bill to repeal the Public Utility Holding Company Act of 1935 (the 1935 Act). I am Floyd W. Lewis, Chairman and President of Middle South Utilities, Inc., which is one of the 12 holding company systems still fully regulated under the 1935 Act. I appear on behalf of the Edison Electric Institute (EEI), the association of investor-owned electric utility companies. Its membership is composed of substantially all of the investor-owned electric utility companies in the country, and they provide about 77 percent of the nation's electric service.

We agree with the position of the Securities and Exchange Commission (SEC) as expressed by the Chairman in his letter to Senator D'Amato, dated December 21, 1981, that ". . . this statute (the 1935 Act) has served its basic purpose and that continued federal regulation of utility holding companies is unnecessary and inappropriate."

We also agree with the following additional points which the SEC made in its letter:

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that "the Commission's task of reorganizing the Nation's gas and electric utility holding company systems was completed twenty years ago."

that "The Commission's administration of the Act in more recent years has primarily involved review of registered holding company financings, mergers, and acquisitions and the consideration of requests for exemptions from the Act."

that "these abuses (which lead to the original passage of the Act) are unlikely to recur in light of the extensive changes since 1935 in the public utility and investment banking industries, the accounting profession, state utility regulation, expansion of the disclosure requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934, and the development of more efficient and well-informed securities markets."

that "If the 1935 Act is repealed, all publicly-owned utility holding company systems will, of course, continue to be subject to the financial disclosure requirements and other provisions of the federal securities laws."

that "unlike the other statutes it administers, the 1935 Act involves the Commission very deeply in the substance of fundamental management decisions."

that "only twelve active holding company systems remain subject to direct regulation under the 1935 Act. The Act, however, continues to have significant influence on the financing and management decisions of a much larger portion of the industry. Approximately 80 holding company systems operate under various exemptions from the

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Act, and many utilities may be reluctant to form holding companies because they would then have to register under the Act or qualify for an exemption."

A copy of Chairman Shad's letter is attached to my testimony.

We should start our examination of why the 1935 Act should be repealed by a review of what the 1935 Act does.

The 1935 Act requires that all holding companies with subsidiaries engaged in any aspect of the electric utility business or in the retail distribution of natural gas register with the SEC, the agency with authority to enforce the 1935 Act. There are some exemptions from the registration provision which will be discussed below. Presently twelve holding companies fall within the registration provision: Allegheny Power System, American Electric Power Co., Central and Southwest Corp., Columbia Gas System Inc., Consolidated Natural Gas Co., Eastern Utilities Associates, General Public Utilities Corp., Middle South Utilities, Inc., National Fuel Gas Co., New England Electric System, Northeast Utilities, and The Southern Co. Nine are electric utility systems and three are gas utility systems. In terms of 1981 gross revenues, the nine represent about 20 percent of the investor-owned electric utility industry and the three represent about 8 percent of the gas utility industry.

Only a small number of companies are registered holding companies because most holding companies fall within the exemptions of the 1935 Act. Approximately eighty holding companies are in the exempt group. However, it is most important to recognize that these exemptions are discretionary. Holding companies may enjoy the freedom offered by these exemptions only so long as the SEC finds them appropriate.

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The 1935 Act subjects holding companies to two principal kinds of regulation. First, the complex organizations that existed then were simplified, and holding company utility operations were integrated by spinning off geographically unconnected operations. The SEC completed the task of simplifying holding company structures by 1952 and the regulated holding companies of today bear no resemblance to the conglomerates that prompted enactment of the 1935 Act.

Second, the company must obtain SEC approval for most financial and many operational transactions. The filings proposing transactions and the regular reports required to be filed with the SEC to prevent the recurrence of abuses, such as self-dealing, stock-watering, and other types of asset manipulation that occurred in a different era more than a half century ago, is the principal current activity of the SEC in enforcing the 1935 Act.

To understand why such legislation was enacted, we must examine the environment at that time.

In the 1920's the utility industry was undergoing a period of major growth. Since the SEC was not established until 1933, the securities of utilities and of all other industries were not subject to regulation. The boom mentality which pervaded the entire decade and the lack of effective security regulation created a classic speculative bubble.

Utility rates and many other practices that are regulated today were also not subject to regulation. State regulatory agencies at that time were few and very poorly staffed -- as late as 1935 there were still only 22 states that regulated rates. Court decisions strictly limited state regulatory authority and there was no federal

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commission, such as the FERC, that regulated utilities' interstate rates. Moreover, the courts were particularly liberal in allowing utilities to set a value on their own property for purposes of ratemaking, sales or security issuance. With little regulation on either the state or federal level, an unsophisticated investing public, and a rapidly expanding industry, the scene was ripe for security violations.

The main use and abuse of the holding company form of organization that precipitated the 1935 Act was the use of a small controlling interest as a means of controlling large amounts of capital through what is known as "pyramiding." When the giant Insull utility trust collapsed in 1929, there were more than 10 layers between the operating companies and the controlling group at the top. Using these methods, individuals and groups were able to control large collections of capital with only small amounts of their own actual investment. The Congress did recognize that there are many advantages of a holding company form of organization to both investors and consumers, such as providing greater stability of earnings by evening out the variable performance of the different operating subsidiaries of a company due to different sales patterns, the extent of involvement in a construction program, or the results of local regulation.

To address the widespread abuses in the entire securities industry, the Congress enacted the Securities Act of 1933 and the Exchange Act of 1934 (1933 and 1934 securities acts), which require disclosure of a variety of information when a security is publicly distributed and held. These acts are extensive and the SEC enforcement of them is

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vigorous. As a result, investors are protected from unscrupulous dealings because of the detailed disclosure requirements of these acts. These acts are the backbone of the effective securities regulation we enjoy today. In many cases, the 1935 Act merely duplicates the provisions of these acts.

For instance, the SEC now requires utilities to utilize specific accounting standards and specific forms and contents of financial statements included in SEC filings. The SEC derives its authority to require these from the 1933 and 1934 securities acts. While the 1935 Act provides similar authority, the SEC does not rely upon the 1935 Act authority but uses its other authorities to require uniform accounting standards for public utility companies. Moreover, uniform accounting standards are required by the Federal Energy Regulatory Commission (FERC) for its regulation of the industry. Thus, the 1935 Act is not needed to prevent asset manipulation, overcapitalization, or other accounting abuses. In addition, the development of a sophisticated accounting industry has led to the adoption of uniform accounting standards for all industries and businesses.

In retrospect, the 1933 and 1934 securities acts with their disclosure requirements and the development of professional accounting standards would have been sufficient to reveal which utilities were on a sound financial basis and which were not. Individual investors armed with this information would reject companies that were overcapitalized.

The 1935 Act was passed principally because Congress wanted an orderly dismantling of the complex and far-flung holding company

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systems in existence at that time into simpler organizations and also because Congress did not know what great successes the 1933 and 1934 securities acts would be in curbing security abuses. There was no track record under these acts at the time the 1935 Act was passed.

Another provision that Congress included in the 1935 Act provides that transactions among affiliates in a holding company system come under SEC regulation. However, both the FERC and state public utility commissions now have the authority to scrutinize such affiliate transactions. The FERC's authority to set wholesale rates gives it the ability to examine the amounts paid to affiliates by utilities and to disallow expenses that are found to be unreasonable. State public utility commissions also currently have the authority to examine the reasonableness of expenses incurred or property added to the rate base of individual utilities whether through transactions with affiliates or otherwise.

Any claim that state public utility commissions cannot control affiliate transactions is of questionable validity. If the reasonableness of a particular transaction is not shown, they can disallow that expenditure from the computation of allowed rates, thus striking at the heart of a utility's operations. Various of the utility regulatory commissions of the states in which Middle South's subsidiary utilities operate, Arkansas, Louisiana, Mississippi and Missouri, have reviewed the financial records of our service subsidiary and our fuels company to examine the basis for charges between System companies.[--] It is instructive to note that they have performed their own audits of affiliates and have not relied upon the SEC.

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The abuses that arose during the 1920's that resulted in the passage of the 1935 Act represented a unique period of economic history which could not be repeated today for a number of reasons, not the least of which is effective state and federal regulation of the utility industry which has developed over the last 47 years. The amount of intense scrutiny that utility companies receive today from sources other than the SEC holding company staff is more than sufficient. The 1935 Act is a prime example of legislation which has served its purpose and, because of changed circumstances over the 47 years since its enactment, is no longer needed and should be repealed.

Some might argue that, since essentially all of the requirements of the Holding Company Act are embodied in other legislation, there is no reason to repeal the Act. They would say that, precisely because the Act is currently duplicative, repeal of the Act would be of small benefit.

I would take issue with those arguments on both philosophical and practical grounds. We believe that existing laws and regulations should be justified. In a period when our troubled economy is burdened with heavy regulatory costs which contribute to the weakness of our industrial capacity, and when Congressmen are forced to make extremely tough, unpleasant choices among programs which serve real needs, we believe that the burden of proof must be borne by those who want to keep regulation in place. They should be required to present substantial evidence that the laws and/or regulations in question are still needed, not just that they don't do much harm.

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We submit that since attainment of its basic objectives, the 1935 Act has done harm. The 1935 Act which was set up to protect investors and ratepayers has often produced results to their detriment. We will endeavor to show this by reference to experience under the Act, in many instances referring to my own company.

The requirements of the 1935 Act are wasteful. The estimated expenses incurred by the Middle South System associated with the various Holding Company Act filings for the one-year period June 30, 19e0, through June 30, 1981, total $465,000. Other registered holding companies doubtless incur comparable costs, and these are only the direct costs to utilities and do not include the cost of lost opportunities due to regulatory red tape.

SEC approval is required for numerous regular transactions ranging from sale and leaseback of oil storage tanks to the establishment of a bank line of credit. The provisions and policies of the Holding Company Act have impaired the financing activities and operations of companies subject to the Act and, as a result, have adversely affected management flexibility and the competitive position of such companies in relation to non-holding company utilities. Generally, in addition to the time required for preparation of a filing, there is at least a 60-day waiting period between initial filing and receipt of an order under the 1935 Act permitting the transaction. Because of these long delays, registered holding companies and their subsidiaries are unable to take advantage of "windows" in the financial markets and many transactions with "short fuses" never get off the ground, thus preventing management

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from further reducing the cost of capital. Other companies with which we must compete in the financial markets do not have this extra burden.

We can see no circumstances where there is real need for the filing of a Registration Statement under the 1933 Act and also the presently required filing under the 1935 Act. Many other filings are duplicative also. Companies subject to the 1935 Act are required to file an Annual Report, Form U5-S, with the SEC. In addition, the same companies are required to file an Annual Report, Form 10-K, with the SEC under the 1934 Act. The reports include duplicative information. This puts an unnecessary burden on the companies to render the same information twice to the SEC and as a result increases costs to the companies and their customers.

In the area of financing, the Holding Company Act dictates numerous requirements which, singularly and in the aggregate, have limited the ability of the registered companies to tailor the terms of their securities to reflect the frequent and sudden changes occurring in the volatile securities markets. Several of these deserving of further discussion are the competitive bidding requirements under the Act in connection with sales of securities and the formal Statements of Policy under the Act governing the terms of First Mortgage Bonds and Preferred Stock.

Rule 50 under the Holding Company Act in general precludes the issuance and sale of securities except pursuant to competitive bidding. This requires publication of a formal invitation for bids and the receipt of competitive proposals for the purchase of securities at least 6 days after publication. Absent unusual circumstances

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or adverse market conditions, registered holding companies and their subsidiaries have been precluded from engaging in negotiated public offerings of securities or private placement transactions, financing alternatives which have been and are available to many other electric utilities.

The Statement of Policy Regarding First Mortgage Bonds has tended to make those companies which are regulated under the Holding Company Act less competitive in the market place, resulting in higher interest costs to the borrowing company and, therefore, higher costs to ratepayers. These restrictions generally are not desired by investors. In fact, some restrictions required under the Act may result in higher interest demands by investors.

For example, under the Holding Company Act, a company must comply with redemption restrictions in an era when a creative response to market conditions would dictate other redemption provisions. Other utilities have been able to negotiate the circumstances under which a particular series of bonds would be redeemable. Companies subject to the Act are limited to a restriction on optional redemption prices which has not satisfied many investors in this volatile market. Potential investors appear to be greatly concerned about the possibility that their bonds might be redeemed before they become due. Our inability to respond to these concerns is costly.

Companies subject to the Holding Company Act are further burdened by the Statement of Policy's artificial limit on earnings that may be counted in determining whether a company may issue First

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Mortgage Bonds. For example, under the Act, no more than 10 percent of the earnings used to meet the issuance test generally required on utility bonds can come from a source other than utility revenues. The industry norm allows this figure to be 15 percent. Yet, under the Act, companies are forced to reduce their mortgage test from the 15 percent standard generally acceptable to lenders to 10 percent. This has unfairly cut our bond interest coverage ratios in comparison with other companies which have a 15 percent standard. It has also tended to affect adversely investors' perceptions of our credit worthiness, resulting in higher interest costs on debt and more expense to ratepayers.

Companies subject to the Holding Company Act must include sinking and improvement fund and replacement fund provisions for bonds. The market long ago ceased to care about these funds and, in fact, fears early redemption of bonds through these provisions. Most electric utilities have eliminated these funds from their current and future financings and are, therefore, more attractive to investors.

In addition, Holding Company Act companies must use property to meet the requirements of these funds which could otherwise be available to support issuance of additional debt. This, again, puts us at a great disadvantage in relation to our fellow utilities. With the same amount of property, we have less ability to issue bonds, a fact which may be perceived by the market as making us a higher credit risk.

In addition, the Statement of Policy Regarding Preferred Stock and the practice of the Commission in implementing the Statement of

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Policy have imposed on us a number of rigid requirements which, absent unusual circumstances, have significantly limited the ability of companies regulated under the Act to vary the terms of Preferred Stock to meet changing market conditions. These include, among others, the requirements (1) that provisions restricting redemption of Preferred Stock can only be for a period of up to five years and must be limited to refunding with lower cost money, (2) that optional redemption prices for Preferred Stock must conform to a formula set forth in the Statement of Policy, (3) that mandatory sinking funds for the redemption of Preferred Stock must be calculated to retire not more than 5% of the issue each year beginning with the fifth year after issuance, and (4) that the holders of Preferred Stock be entitled to certain voting rights. In addition, the Statement of Policy Regarding Preferred Stock generally limits the amount of short-term unsecured debt for companies issuing Preferred Stock to not more than 10% of capitalization. In addition to these limitations, companies regulated under the Holding Company Act have long been precluded from developing other types of financing, including sales of convertible debt securities or, for those companies with Preferred Stock outstanding, sales of debentures. Also, companies subject to the Act have been precluded from creating and selling a lesser grade of Preferred Stock generally known as "Preference Stock." At a time of increasing market volatility and heavy capital requirements, companies need maximum flexibility in terms of financing arrangements. The foregoing restrictions serve only to limit management's financing alternatives.

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At one point in time, on the recommendation of a director whose finan al experience and expertise are truly outstanding, the Board of Middle South Utilities, Inc. concluded that the best means of raising capital then being contemplated was by means of issuance of convertible debentures. The chief financial officer was instructed to pursue this matter with the staff of the SEC. He reported that they said they would not approve the proposed plan of financing. After further consideration by the Board of Directors, he was asked to go back to Washington and explore the matter again. My recollection is that he was told that they could not prevent us from making a formal filing but that if we did the staff would see that the matter received a full-blown, drawn-out referral to and hearing by the full Commission. The need to go forward in raising capital on a timely basis forced us to acquiese in the staff's position. I submit this as an illustration of how the SEC staff, by using delaying tactics, can if it chooses, and in many cases it does, substitute its judgment for that of the management and directors of a company subject to the Holding Company Act.

In addition to restrictions on financing, the Holding Company Act has hindered the operations of the Middle South System in a number of other areas. Allow me to cite a few examples.

Mississippi Power & Light Company had entered into an arrangement with Mississippi Fuel Co. in 1973 for the construction and operation in the State of Mississippi of a pipeline to transport natural gas for use as boiler fuel in certain MP&L generating units. Due to changes in fuel supplies, by 1979 only 50 percent of the

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capacity of the pipeline was being used to transport natural gas. MP&L desired to enter into long-term arrangements with third parties to transport natural gas but due to the Holding Company Act was restricted to only those arrangements of a limited duration which could be terminated or suspended at any time by MP&L for its own needs. This has reduced the opportunity to make use of the pipeline for third parties.

Owing to similar considerations under the Holding Company Act in 1976 when tow boats and barges acquired or leased by the Middle South System were not required, due to changes in fuel supply, to be used for transporting oil for use in Middle South System generating stations, the System was only permitted to subcharter these boats and barges on a temporary rather than long-term basis, thereby reducing sub-chartering opportunities. The same position has been taken by the SEC staff under the Holding Company Act with respect to unit trains which the Middle South System leases to transport coal from the western United States to its generating units. These unit trains are seasonally surplus to the System's needs and yet the requirements of the Holding Company Act have restricted the System's ability to sublease the trains fully during times of such surplus.

In 1975, Arkansas Power & Light Company had a supply of uranium which it had purchased at less than $8 a pound and which was excess to its needs. The then present market value was approximately $25 per pound. AP&L desired to sell this uranium to its sister company, Middle South Energy, Inc. at fair market value to obtain the benefits of the profit. Owing to the restrictions in the Holding Company Act, AP&L's options, however, were limited solely to the sale to MSE at cost.

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In 1974, pursuant to national policy that additional domestic petroleum refining capacity should be encouraged, the Middle South System worked with certain entrepreneurs in putting together perhaps the largest grass roots refinery project ever in the United States. It was located on the Mississippi River upstream from New Orleans and would satisfy a significant portion of the fuel oil requirements of the Middle South System which were made necessary because of gas supply curtailments alleged to be pursuant to Federal regulations. Because of the rigidity of the restrictions on entry of companies subject to the Holding Company Act into any other businesses, the Middle South System, even though it provided the key capital component, was prevented from taking an equity position in the refinery. We had to structure our essential capital input as an advance payment for oil to be delivered over approximately a decade. About the time of completion, the refinery was bought by Marathon Oil, with the entrepreneur equity holders realizing a very substantial capital gain. Our System got back only the $67 million which had been advanced with no gain at all. I submit that neither investors nor customers were benefited by the Holding Company Act preventing our having taken an equity position and shared in the handsome gain realized.

In 1972, System Fuels, Inc. was organized as a fuel subsidiary in the Middle South System to plan and implement programs for the procurement of fuel supplies for the System. As originally established under the Holding Company Act, SFI was permitted to engage in efforts for the development and procurement of oil and gas supplies and other fuels, and for the transportation, handling and storage of these

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fuels, pursuant to general programs approved under the Act covering periods of several years, thereby affording the management of SFI substantial flexibility in the carrying out of its fuel programs. In more recent years, however, the SEC holding company staff has stepped up its regulation of the System's fuels activities and the management of SFI has been burdened with having to justify on a yearly basis, with detailed budgets and descriptions of future developments in its fuels programs, its continued operation and estimated future financing requirements. This increased regulation has worked to inhibit management's ability to make and implement timely decisions.

Another area in which the Holding Company Act and the regulations under it impose a decided handicap on companies subject to the Act as compared to other electric utilities are the very stringent restrictions on commercial banking connections for directors. About 12 or so years ago when I was President of Louisiana Power & Light Company, I was able to secure the agreement of Mr. John G. Phillips, President of Louisiana Land and Exploration Company, to join the Board of Directors of Louisiana Power & Light Company. He was already well recognized as one of the outstanding business leaders of the New Orleans area and very prominent in the civic life of the community. He was at that time serving as a director of the Bank of New York, an institution with which Louisiana Power & Light Company had no banking relationship. Feeling that Mr. Phillips would be a most valuable addition to the Louisiana Power & Light Company Board of Directors, we requested the SEC to approve our electing him. The request was summarily rejected by the SEC staff as not meeting any of the specific criteria of the Categories of Exemptions in Rule U-70.

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Since that time, Mr. Phillips has become Chairman and Chief Executive Officer of Louisiana Land and Exploration Company, has been elected to the board of The Travelers Insurance Company, to the board of Allis-Chalmers Corporation, and became Chairman of the Board of Administrators of Tulane University. In the latter role, he brought the University's fiscal condition from a pattern of well over 10 years of unending deficit operations to operations in the black during the last two most difficult of years. It is difficult to see how denying us the services as a Director of this outstanding business executive has served the best interests of anyone, and particularly the investors and customers of our System. One of the classes of exemptions for directors having commercial banking connections is with a banking institution having combined capital and surplus not in excess of $2.5 million. That number has been unchanged for 36 years notwithstanding the effects of inflation and the growth of banking institutions.

A number of years ago, the Middle South System sought to implement a Stock Option Plan to help attract and hold talented executive personnel within the System. It encountered substantial regulatory resistance and was able to implement a modified plan over the objections of the SEC staff only after protracted proceedings and carrying the matter all the way to the Securities and Exchange Commission itself. Why should a public utility holding company and its subsidiaries be treated any differently than other electric utilities, or any other business for that matter, on matters such as the use of stock options as part of a compensation plan? Why should members of the SEC staff sit in judgment on such matters, which in any event

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must be submitted to the shareholders of the corporation for a vote?

A very recent example involves guaranties by Middle South Utilities, Louisiana Power & Light Company, and New Orleans Public Service Inc. in connection with bank financing for the 1984 Louisiana World Exposition. Of all the corporations, companies, and individuals who have signed such guaranties which support a bank line of credit for this World Exposition, only the three companies of the Middle South Utilities System were required to file with the SEC and request permission for a matter involving only a total of $2.5 million of maximum exposure. This was made necessary by the fact that the definition of a "security" under the Holding Company Act is so broad that it encompasses a guaranty of this sort.

I submit that in all of the instances cited, the investor's or the consumer's interests were not well served by regulation under the Holding Company Act.

We cannot see how passage of S. 1977 could harm any consumer's interest. The consumer's interest rests on the utility's ability to provide adequate and reliable service at reasonable rates. As a consequence, the consumer is fundamentally dependent on and benefits from (1) effective and efficient utility management and (2) effective rate regulation; the repeal of the 1935 Act would not erode the latter and would most likely strengthen the former. The consumer also benefits when (3) the costs of regulation are reduced, and (4) the costs of opportunities lost to utilities are minimized; repeal is also likely to result in such benefits.

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Federal and state rate regulators have primary responsibility for ensuring that customer rates reflect only legitimate costs of utility service. The repeal of the 1935 Act would not diminish the existing powers of rate-making authorities to fulfill that responsibility.

Both state and federal rate regulators have considerable experience in setting reasonable rates for customers of utilities affiliated with non-utility businesses. Standardized accounting practices, coupled with auditing and enforcement authority, have enabled rate regulators to routinely allocate the costs of capital, goods and management services between utility and non-utility businesses.

As we have discussed before, consumers may also be concerned that repeal of the 1935 Act will eliminate controls over charges paid in affiliate transactions. But that concern is misplaced. The 1935 Act does require intercompany transactions to be undertaken at cost, limiting any profit to affiliates paid by utility companies. However, over 80 percent of the U.S. electric utility industry is exempt from this requirement. Their customers have historically relied on ratemaking authorities to scrutinize affiliate transactions to prevent abusive transfer charges. No discernible impairment of consumer interests has resulted from this reliance. Again, existing rate regulatory powers are adequate to deal with questions in this area.

We find it hard to believe any argument that, after repeal of the 1935 Act, there would be insufficient regulation. We believe that excessive and unwise regulation is a prime reason that the

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electric utility industry today faces a grave financial crisis. Our stock prices are below book value, our achieved rates of return are inadequate, and our credit ratings trend steadily downward. The bond issues of some utilities are now being rated too low to qualify for institutional investment portfolios, further reducing their marketability and increasing their interest rates. In 1980, the average return on common equity allowed by regulatory bodies was 14.3 percent. The average return actually earned in 1980 was only 11.4 percent.

It is clear that the utility industry's financial condition must be improved or everyone, investors and consumers, will suffer. We are not asking for a handout. We are only asking for the removal of an unnecessary part of the heavy regulatory burden we must bear. Senator Johnston's bill S. 1977 would accomplish this and, at the same time, reduce unnecessary government expenditures that could be applied to more urgent needs. We urge the passage of S. 1977.

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APPENDIX A

EFFECT OF STATE LAWS AND REGULATIONS
ON UTILITY DIVERSIFICATION

INTRODUCTION

State laws and regulatory practices regarding utility diversification have entered a period of considerable flux. Many electric utilities are expanding the scope of their non-utility business activities and their investments in such activities. Some are also reorganizing their corporate structures to permit such activities to be conducted more effectively. In response to these developments, state regulatory commissions, and at times, state legislatures, are beginning to take a harder look at the scope of state jurisdiction to control or at least monitor and influence these developments. Some, like the Wisconsin Commission, are proposing to expand their rules to control and influence significantly utility diversification activities.

It is somewhat ironic that, at this same time, a settlement of the AT&T anti-trust litigation has been proposed which promises, if implemented, to divest local telephone utilities from major components of the consolidated Bell system. The great majority of state practices and policies regarding the regulation of non-utility affiliates has been generated by litigation involving Bell and other telephone systems. No matter what form of divestiture takes place (it is not clear whether local telephone utilities would operate separately, in a single consolidated company lacking Bell Labs, AT&T Long Lines, Western Electric, etc. or in some other combination), it is likely to have a substantial impact at the state commission level. Additionally, various proposals to amend and/or

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repeal the Public Utility Holding Company Act raise for some observers additional concern about increased state regulation of diversified utilities.

While there has been substantial publicity regarding regulatory involvement in the utility diversification process, it is important to recognize that many utilities successfully operate non-utility businesses with little or no regulatory involvement. The fundamental purpose of this study is to identify potential regulatory impediments to diversification so that a utility contemplating a diversification program can from the outset determine whether such a program is desired and if it decides to go forward, can be aware of regulatory considerations.

This study addresses four major areas of concern. The first section considers the potential extent of regulatory agency jurisdiction by looking at the problem of distinguishing between regulated utility and non-utility activities and by considering the scope and extent of state commission jurisdiction over affiliate transactions. Section two considers cost and capital allocation issues. Potential financing restrictions under securities laws are discussed in section three. Finally, a few recent reorganization proceedings are reviewed to address the extent to which commission may regulate corporate reorganizations intended to promote diversification.

This study is based upon a review of the laws and regulatory and judicial decisions in thirteen states which have experienced considerable diversification activity, particularly in the recent

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past, or which are considered as pace-setters in utility regulation.[1/] It also relies upon the results of an EEI legal and regulatory survey of member companies, relevant articles, treatises, major cases in other states and discussions with company personnel to identify trends of general importance. Since state laws and regulatory practices regarding utilities are so varied, and since many potentially important proceedings are as yet unresolved, this study does not reach conclusions regarding the state of the law. Rather, it attempts to identify 1) important areas of concern to a utility contemplating diversification; 2) relevant trends in the development of the law, including competing points of view which may exist among the states; and 3) cases which illustrate these matters. No generic study such as this can substitute for a company's understanding and knowledge of the laws as well as the intangible factors which affect the regulatory environment in which it operates. Obviously, any company contemplating a diversification strategy would supplement this survey with a more detailed analysis of the laws and practices of the jurisdictions in which it operates.

1/ These states are: California, Hawaii, Idaho, Illinois, Iowa, Louisiana, Maine, Michigan, Montana, New York, Utah, Virginia and Wisconsin.

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I. REGULATORY AGENCY JURISDICTION OVER NON-UTILITY AFFILIATES

In theory, regulatory commissions do not regulate the business operations of non-utility businesses affiliated with a regulated utility. The Supreme Court of Iowa has stated:

> A public utility can do business in areas not covered by its utility rights and obligations. In so doing the utility acts in a private capacity as distinguished from its public capacity and as to such actions it is subject to the same rules as any other private person. Iowa State Commerce Commission v. Northern Natural Gas Co. 161 N.W. 2d 111, 113 (S. Ct. Iowa 1968).

Several state statutes implement the same approach. Section 54 2-1(30) of the Utah code provides:

> Any corporation or person not engaged in business exclusively as a public utility as hereinbefore defined shall be governed by the provisions of this title in respect only to the public utility or public utilities owned, controlled, operated or managed by it or by him, and not in respect to any other business or pursuit.

The Missouri code exempts from utility regulation non-utility business affiliates which are "substantially kept separate and apart" from the utility business. Mo. Rev. Stat. §393.140(12). In accordance with this approach, utilities in many states have operated non-utility businesses successfully for a considerable period of time. Nevertheless, some states may limit the business activities in which a utility may engage. Va. Code §§13.1-2.1, 13.1-50; Roanoke Gas Company v. Commonwealth, 234 S.E.2d 302 (S. Ct. Va. 1977); Lynchburg Gas Company v. Commonwealth, 234 S.E.2d 305 (S. Ct. Va. 1977).

However, even when permitted, non-utility operations have in many instances not been completely free from regulatory scrutiny or consideration. Even if a state does not directly regulate

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non-utility businesses, it may nevertheless require a utility to make available to the commission records of the operations of non-utility affiliates. The exact scope and coverage of the obligation may vary from state to state. Montana law provides:

> Every public utility engaged directly or indirectly in any other business than those mentioned in [the statutory definition of public utility] shall, if required by the commission, keep and render separately to the commission, in like manner and form, the accounts of all such other businesses, in which case all the provisions of this chapter shall apply with like force and effect to the books, accounts, papers and records of such other businesses. Mont. Rev. Code Ann. 69-3-202(2).

Section 476.9(2) of the Iowa code contains virtually the same provisions, but additionally provides that "all profits and losses [of non-utility businesses] may be taken into consideration by the commission if deemed relevant to the general fiscal condition of the public utility." In Maine, the Commission has the authority to impose a record keeping requirement on any "public utility engaged directly or indirectly in any other subsidiary business." 35 Me. Rev. Stat. §54. The Maine Commission may also require access to the books and records of any affiliated interest which directly or indirectly owns or exerts substantial influence over a utility. 35 Me. Rev. Stat. §104.

A. Distinguishing Between Utility and Non-Utility Businesses

Initially, it is important to clarify the distinction between a utility and non-utility business. Virtually every state statute contains a definition of "public utility" for purposes of defining the entity subject to commission regulation. These definitions

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generally are broad enough to include any person or corporation which owns, controls or operates facilities for generating and distributing electricity for public consumption.2/

Several states have recently passed legislation modifying the definition of public utility to exempt small power production facilities, alternative energy and/or cogeneration facilities. New York permits utilities to operate such subsidiaries provided that the subsidiary operates independently from the utility, deals with the utility only on an arm's length basis and complies with certain other requirements. N.Y. Pub. Serv. Law §66-c. Many other states which permit such companies to operate as unregulated affiliates subject those companies to regulation if a utility maintains a controlling interest. 35 Me. Rev. Stat. §§2323, 2324; Mich. Stat. Ann. §22.13(6d); Cal. Pub. Utilities Code §218. States

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2/ For example, California defines "public utility" to include an "electrical corporation" (Cal. Pub. Utilities Code §216) which is in turn defined as "every corporation or person owning, controlling, operating, or managing any electric plant for compensation within this state, except where electricity is generated on or distributed by the producer through private property alone solely for his own use or the use of his tenants and not for sale to others" (Id. at §218). Iowa defines "public utility" as "any person, partnership, business association, or corporation, domestic or foreign, owning or operating any facilities for: 1. Furnishing...electricity to the public for compensation." Iowa Code Ann. §476.1. Maine defines "public utility" to include every "electrical company" and defines the latter to include "every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any electric plant for compensation within this State, except where electricity is generated on or distributed by the producer through private property alone solely for his own use or the use of his tenants and not for sale to others." 35 Me. Rev. Stat. §15.5, 15.13. See also Mont. Rev. Code Ann. §69-3-101.

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may also impose other statutory restrictions on utility business operations. New York, for example, requires a utility to engage in encouraging home conservation measures, but imposes specific restrictions on the manner in which the utility conducts this business. N.Y. Pub. Serv. Law §1350h.

In addition, many states regulate business enterprises which are integrally related to the conduct of a utility business. The Supreme Court of Michigan has held that a wholly owned subsidiary of a public utility which is organized to construct and operate a nuclear power plant and which sells the production from the plant to its parent utility is considered a public utility under the laws of Michigan. Indiana & Michigan Power Co. v. State, 275 N.W.2d 450 (S. Ct. Mich. 1979).

In many cases, the distinctions drawn between a utility and non-utility business are obvious. However, where a business activity is independent from but related to utility operations, such as a fuel or gas exploration subsidiary, that activity may be treated essentially as a utility and subject to financial and other controls. A review of relevant cases suggests that the following factors among others are important to regulatory commissions in determining whether a business should be considered as utility or non-utility:

1. whether the business activity has been included or excluded in the utility rate-base, or in utility plant account;
2. whether the utility desires to treat the business as utility or non-utility;

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3. whether separate records have been kept for the different businesses;
4. whether the business activities have been conducted under independent corporate structures, and
5. whether the regulatory commission determines that the business activity involves potential risk to utility ratepayers.

The importance of these factors is illustrated by the varying treatment provided to utility fuel and exploration subsidiaries. The Michigan Public Service Commission has treated Northern Michigan Exploration Company, a gas exploration subsidiary of Consumers Power, as non-jurisdictional since the inception of that subsidiary. The Commission explained its position, stating:

> [S]hould the stockholders allocate corporate funds available to them in the form of either retained corporate earnings or funds available for dividends...any successful venture should inure to the benefit of the stockholders. The ratepayer is to bear no cost in exploration and, as a consequence, we can see no reason why the ratepayer should glean the benefit. Our position is specifically predicated on the generally recognized view that exploration for gas and/or oil is highly speculative in nature. Therefore,...your company's efforts to discover new sources for gas is commendable but, by reason of the speculative nature of this business, the Commission believes that the company, not the ratepayers, should benefit from any reward achieved by such exploration and development. Letter from Willis F. Ward, Chairman, Michigan PSC to J. B. Falahee, Consumers Power Co., July 7, 1980.

Similarly, in July, 1978, the Michigan PSC found that operations of Consumers' uranium exploration subsidiary should be treated as non-jurisdictional and excluded from rate base because "the venture is speculative and is properly the risk of the investors.... [U]ranium

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exploration is an open-ended venture and it would be even more difficult than usual to separate the prudent from the imprudent investment." Consumers Power Co., 25 PUR4th 167, 183 (Mich. PSC, 1978).

The Louisiana Supreme Court has similarly held in Central Louisiana Electric Co., Inc. v. Louisiana Public Service Comm., 373 S.2d 123 (La. 1979) (CLECO), that the Commission may not capture the profits of CLECO's wholly-owned gas production and pipeline subsidiary. The Court noted that the subsidiary, Louisiana Intrastate Gas Corporation (LIG), had since its inception maintained separate officers, headquarters and employees from those of CLECO, served many customers other than CLECO and that its prices in transactions with CLECO were fair and reasonable when compared to those involving its other customers. In view of those factors, the Court reversed the Commission's decision to include a portion of CLECO's investment in LIG in CLECO's rate base even though CLECO purchased all of its gas from LIG. It appears that LIG's facilities were never included in CLECO's rate base.

In City of El Dorado v. Arkansas Public Service Comm., 362 S.W. 2d. 680, 685 (S. Ct. Ark. 1962), the Court affirmed a Commission decision to allow a gas utility (the Arkansas Lousiana Gas Company) to operate a non-utility subsidiary which extracts and processes liquid hydrocarbons from natural gas. The Court held that a utility may engage in and retain the profits from a private non-utility business as long as it pays all the expenses of that business. The Court also pointed out that the utility must "keep its books

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in such a way as to be able to inform the Commission so it could make a proper ruling" as to how expenses are allocated. Id. at 685.

In Application of Oklahoma Natural Gas Company, 406 P.2d 273, 276 (S. Ct. Ok. 1965), the Court similarly upheld Commission treatment of a separate oil and gas exploration subsidiary as a non-utility business. However, it made clear that where a company made no effort to segregate these business activities from its utility operations and did not provide records distinguishing the costs for these operations, the Commission should properly regulate such business as "utility" property for ratemaking purposes. Id. at 277. Many gas utilities have followed this latter approach to voluntarily include in their rate base expenses for gas exploration and drilling programs. E.g., State v. Pub. Serv. Comm. of Oklahoma, 614 P.2d 1100, 1102 (S. Ct. Ok. 1980).

Utilities which initiate various business activities as part of their regulated operations and include the cost of such activities in their rate base often find it difficult, if not impossible, to subsequently have those business activities treated as non-utility. This problem has most notably occurred when utilities attempt to separate oil production operations which began as an incidental aspect of gas exploration activities. In Re Michigan Consolidated Gas Co., 78 PUR3d 321, 324 (Mich. PSC 1968), the Commission refused to treat such incidental oil operations as a non-utility business when the oil was discovered as part of a gas exploration program which had traditionally been included in rate base.

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This same problem has faced Mountain Fuel Supply Company, a gas utility in Utah, for many years. Mountain Fuel's gas exploration program was originally accounted for as a utility expense, the costs of which were recovered through gas rates. During the 1970's the Commission ordered an increasing portion of the exploration and development expenses to be paid from non-utility accounts. Following a Commission order which essentially treated the oil program as a utility operation, Mountain Fuel organized a subsidiary, Wexpro, to which it transferred its oil properties. The Utah Supreme Court reversed a Commission decision approving this transfer and held that the Commission must classify the property involved as utility assets if:

> (1) the property, while undeveloped, was held in a utility capital account upon which the ratepayers paid a rate of return, (2) funds from the utility exploration and development expense accounts were applied to the development of the property involved or (3) natural gas was produced from the property. Committee of Consumer Services v. Public Service Commission, 595 P.2d 871, 878 (S. Ct. Utah 1979), cert. denied, 100 S. Ct. 664 (1980).

However, the Utah Commission recently approved a complicated agreement to clarify the treatment of Mountain Fuel's oil and gas operations. The agreement effectively permits both ratepayers and shareholders to share the benefits of these oil and gas operations. Under this agreement, oil and gas on currently productive property will be sold to Mountain Fuel at cost of service rates. Wexpro will conduct all oil and gas production and exploration activities and will be paid for these services according to detailed formulas. Mountain Fuel's other 'wildcat' oil and gas properties will be

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allocated to a new non-utility subsidiary, Celsius. Oil and gas which is discovered on these properties will be sold at market rates, after payment of expenses to Wexpro and royalties to Mountain Fuel. Any remaining profits will be divided between Wexpro and/or Celsius Mountain Fuel. The validity of this arrangement will probably be litigated in the Utah courts.

B. Affiliated Transactions

State regulatory agencies generally have the authority to examine the transactions between a public utility and its corporate affiliates. Certain state statutes specifically empower regulatory commissions to scrutinize transactions between affiliates. While each state's definition of "affiliated interest" varies, the jurisdictional threshold is often based on stock ownership, management or service contracts, common corporate directors, common officers or the exercise of substantial influence over the policies and actions of a public utility. See, Va. Code §56-76; N.Y. Pub. Serv. Law §110, 35 Me. Rev. Stat. §104; Iowa Code Ann. §476.8; Mass. Gen. Laws Ann. Ch. 164, §76A; 66 Pa. Cons. Stat. §2101. Such statutes generally require that contracts between a utility and an affiliate be either approved by or filed with the commission before the contract can be effective. These statutes often permit a commission to disapprove a contract which it determines is not in the public interest or to disallow unreasonable profits on utility transactions with affiliates. N.Y. Pub. Serv. Law §110, Iowa Code Ann. §476.8. The utility may bear the burden of establishing the reasonableness of

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such transactions. Iowa Code Ann. §476.8. Some commissions are also explicitly afforded access to affiliate book and records. 35 Me. Rev. Stat. §104.

In the absence of specific statutory authority to regulate affiliate transactions, some state courts have held that there is implied authority to review affiliate transactions under general ratemaking statutes. Such authority is considered a logical corollary to the ability of a commission to review utility expenses to prevent unreasonable costs for materials and services from being passed on to ratepayers. Chicago and Grand Trunk Ry. Co. v. Wellman, 143 U.S. 339 (1892).

In Central Louisiana Electric Co. v. Louisiana Public Service Commission, supra., 373 So.2d at 126, the Supreme Court of Louisiana held that the public service commission had the authority to review transactions between affiliates since it had specific statutory authority to disallow operating expense amounts paid by the utility which are "unjust or unreasonable and designed for the purpose of concealing, abstracting, or dissipating the net earnings of the public utility." La. Rev. Stat. 45:1176. The Court stated "[m]anipulation by a parent utility of a subsidiary for the purpose of creating excessive profits at the expense of the rate payer would provide a reason for the regulatory agency to disregard corporate entity and attribute subsidiary assets and earnings to the parent." 373 So.2d at 126.

In view of the authority of state commissions to scrutinize transactions between affiliates, it is important to focus on the manner in which a commission may exercise that authority. State

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regulatory agencies and courts generally apply one of two basic standards to determine the reasonableness of transactions between affiliates. The first standard, sometimes called the "traditional approach" is used in a majority of states. This approach views the affiliate as an independent entity and gauges the reasonableness of the prices and profits earned on affiliate transactions by comparing them to the prices and profits of similar enterprises. The second standard, called the "California approach," considers the affiliate as part of the utility for ratemaking purposes. As a result, the utility's permitted level of expenses is adjusted so that the affiliate's return on its transactions with the utility is effectively limited to the return allowed the utility in its most recent rate case.3/

The traditional approach, as noted above, views the subsidiary as an independent entity and compares the prices and levels of profits on the affiliated transactions with the prices and profits of comparable enterprises. A number of cases have held that the fact that the price charged by an affiliate to the utility is the same as that charged to independent entities for the same product or service establishes the reasonableness of the transaction. State v. General Telephone Co., 281 N.C. 318, 189 S.E.2d 705 (1972); Montana-Dakota Utilities Co. v. Public Service Commission, 102 N.W.2d 329 (S. Ct. N.D. 1960).

3/ For a thorough discussion and listing of cases involving the two approaches, See, Treatment of Affiliated Transactions in Utility Rate Making: Western Electric Company and the Bell System, 56 BUL Rev. 558 (1976).

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Other cases have held that the controlling factor is whether the affiliate's rate of return is fair as compared with the rate of return earned by similar businesses. Central Louisiana Electric Co. v. Louisiana Public Service Commission, supra., 373 So.2d 123; General Telephone Co. v. P.S.C., 537 S.W.2d 655 (Mo. App. 1976). In the CLECO case, the commission attributed to CLECO $7 million which its natural gas pipeline subsidiary, LIG, had earned in transactions with CLECO, and justified its action because LIG had earned a 45% return on equity. 373 So.2d at 126. In reversing this decision, the Supreme Court of Louisiana stated that the proper scope of the commission's inquiry was "not the level of price at which the inter-affiliate transaction is accomplished in comparison with prices in non-affiliated transactions, but instead whether there is a level of earnings by the wholly-owned subsidiary at a rate higher than the subsidiary's fair rate of return." 373 So.2d at 129. The Court remanded the case to the Commission to determine the fair rate of return for the subsidiary's business.

The "California approach," as one might suspect, is the result of a line of decisions from the California courts. The approach evolved from rate proceedings involving Pacific Telephone and Telegraph Company before the California Public Utility Commission. In Pacific Tel. & Tel. Co. v. P.U.C., 401 P.2d 353 (S. Ct. Cal. 1965), the Court rejected Pacific Telephone's claim that the reasonableness of prices it paid to an affiliated supplier (Western Electric) is established by showing that such prices are as low as those for which the goods could be purchased otherwise. In that

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case, the Court found that the affiliated supplier occupied a dominant position in the marketplace and that, as a result, no valid comparisons could be made with other companies. The Court stated:

> The advantage that the Bell System has...[as] operator of 80 percent of the telephone business in the entire continental United States makes it impossible to compare one phase of its operations, that of Western Electric, with outside companies who have none of the same spread of operations and control either in utility businesses or with respect to any business within which the outside companies operate. 401 P.2d at 369.

In City of Los Angeles v. Public Utility Commisson, 497 P.2d 785, 795 (S. Ct. Cal. 1972), the Court reaffirmed its position, stating that where a utility enjoys a dominant market position, "it may not through the use of corporate diversification obtain a greater rate of return than the utility would be entitled to in the absence of the separate corporate entities." The theory underlying this approach is that a utility "should not be permitted to break up the utility enterprise by the use of an affiliated corporation and thereby obtain an increased rate of return for its activities." Id. at 795. For examples of other cases using this approach, see Illinois Bell Telephone Co. v. Illinois Commerce Commission, 55 Ill.2d 461, 303 N.W.2d 364 (1973) and Re New England Telephone & Telegraph Co., 13 PUR4th 65 (Me. 1976).

Although the "California approach" limits the affiliated subsidiary to "no greater rate of return than would be reasonable for a regulated utility" City of Los Angeles v. Public Utilities Commission, 497 P.2d at 795, the approach does not mandate the reverse where the affiliate's return is less than the parent utility's rate of return. In rate Decision No. 88232,

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Pacific Telephone argued to the California Public Utilities Commission that Western Electric's return should be raised to the permitted rate of return for Pacific Telephone when Western Electric's return had fallen below that figure. The Commission, however, rejected that argument. It stated:

> We...see nothing to indicate that this decision or any other decision requires us to adopt a "reverse" Western Electric adjustment whenever Western Electric's rate of return is below Pacific's for the test year. While Pacific's argument is tinged with plausibility, it overlooks the underlying purpose of the Western Electric adjustment, that is, to keep the ratepayer from ultimately paying for dealing between affiliates which would result in unreasonable earnings to the unregulated utility. Pacific Tel. & Tel. Co., 83 PUC 149, 188; Dec. No. 88232 (1977).

While the "California approach" has been used primarily in rate cases dealing with the operating units of the Bell System and its manufacturing subsidiary, Western Electric, several state public utility commissions have attempted to apply the California approach to electric utility purchases of coal supplies from an affiliated supplier subsidiary. These decisions have generally been rejected by State courts. For example, in Montana-Dakota Utilities Co. v. Bollinger, 38 St. Rep. 1221 (S. Ct. Mont. 1981), the Court rejected the California approach and held that utility transactions with captive coal companies should be judged by the market price or comparable earnings approach. Montana-Dakota Utilities Company (MDU) had established before the Montana PSC that MDU's purchases were only 34% of the total sales of its coal subsidiary, Knife River, that the purchase price was below the comparable sales price in the market place and that the subsidiary's profits were only slightly greater than those of comparable coal companies. Despite

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this showing, the Montana Commission disallowed a percentage of MDU's payments to Knife River by limiting Knife River's return on its sales to the overall utility return allowed MDU. On appeal, the Montana Supreme Court remanded the case and directed the Commission to review the transfer price either in comparison to the market price of coal or in light of returns earned by comparable coal companies. The Court emphasized that a natural resource company such as Knife River, doing most of its business with non-affiliates, was entitled to a significantly greater return than if it were a utility or were selling its full output of coal to MDU.

In Application of Montana-Dakota Utilities, 278 N.W.2d 189 (S. Ct. S.D. 1979), the South Dakota Supreme Court resolved the identical factual situation as Bollinger in a similar manner as the Montana Court. While the Court accepted the Commission's finding that Knife River's 37.45% return on sales to MDU was excessive, it rejected the Commission's decision to limit Knife River to the parent utility's rate of return and directed the Commission to evaluate the reasonableness of the affiliate coal transactions based upon returns to other coal companies. Id. at 194.

The States of Washington and Idaho have been addressing a similar issue raised by sales of coal from a mine owned by Widco, an affiliate of Washington Water Power (WWP), and by Pacific Power and Light (PP&L), to the Centralia power plant, which WWP, PP&L and several other utilities jointly own. WWP and PP&L are excluded from any involvement on behalf of Centralia in negotiations for Centralia's purchases of coal from Widco in order to permit arms-length bargaining.

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WWP has consistently sought to treat its interest in Widco as non-utility; but PP&L treats its share of Widco as utility property. Under these circumstances, WWP has faced considerable resistance in obtaining non-utility treatment for Widco. The Washington Commission had attempted to adjust WWP's rates in such a manner as to effectively limit some of its earnings from Widco to a utility return, but was reversed by a Washington court. Washington Water Power Co. v. Washington Utilities and Transportation Comm., No. 59791 (S. Ct., Thurston County, 1978). The Commission subsequently determined that Widco should be permitted to earn a return higher than that of WWP, but did not actually permit it to recover this return. This decision is now being appealed. The Idaho Commission similarly attempted to apply a utility return to WWP's interest in these transactions, but its decision was remanded by the Idaho Supreme Court for further findings. Washington Water Power Co. v. Idaho Public Utilities Comm., 617 P.2d 1242 (1980). However, that Court appears to have left the Commission with substantial latitude to apply the utility return approach.

The large number of recent cases involving utility transactions with coal affiliates suggests that similar transactions may be analyzed closely in the future. Moreover, the cases appear to be looking to the rate of return earned by comparable businesses as a test for the reasonableness of utility transactions with affiliates. This is likely to be higher than a utility rate of return. However, this approach retains an implicit utility rate base/rate of return philosophy. It also could involve a far more complex evidentiary burden (i.e., defining the investment base from which to calculate a rate of return) than a traditional approach which merely looks to prices in comparable transactions.

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II. COST AND CAPITAL ALLOCATION ISSUES

State commissions may consider, directly or indirectly, in the ratemaking process various aspects of non-utility operations of a diversified company by (1) inquiring whether costs, including income taxes, have been allocated properly between regulated utility and non-utility operations and (2) adjusting the capital structure or other calculations used to compute the regulated utility's permitted rate of return to reflect non-utility operations. Most states which have addressed these issues have based their jurisdiction upon the commission's statutory authority to require just and reasonable utility rates. Virtually every state commission is vested with this authority.

A. Allocation of Costs Between Utility and Non-Utility Businesses

Some state statutes specifically authorize the commission to review the allocation of costs and expenses between a utility and at least some of its affiliated entities. Illinois, for example, provides that the Commission may "inquire into and prescribe the apportionment of capitalization, earnings, debts and expenses" between a public utility and any non-utility business in which the utility is "engaged directly or indirectly." Ill. Rev. Stat. Ch. 111 2/3 par. 12 (1979). See also Mo. Ann. Stat. §393.140(12). New York similarly authorizes its commission to "inquire as to, and prescribe the apportionment of...expenses" between utility and affiliated non-utility businesses. N.Y. Pub. Serv. Law §66(13).

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In a decision approving the reorganization of the Honolulu Gas Company into a subsidiary of a new umbrella holding company, Pacific Resources, Inc., the Hawaii PUC specifically reserved authority to review allocations for costs, including salaries of persons who perform duties for the utility and non-utility businesses; common expenses for facilities, including rent, taxes, depreciation and insurance; expenditures for outside services, including legal counsel, auditing, advertising and public relations; and construction costs. Re Honolulu Gas Co. Ltd. Decision and Order 2762 (Hawaii PUC 1971). It also provided that allocations not deemed proper may be disregarded in a utility rate proceeding for purposes of determining expenses, rate base and rate of return for the utility. Id.

Even when a commission does not assert regulatory jurisdiction over non-utility affiliates, if questions arise as to whether costs, expenses and overhead have been allocated properly between utility and non-utility accounts, commissions generally resolve such matters as within their jurisdiction to disallow unreasonable expenses when regulating utility rates. In order to avoid confusion as to the proper cost allocation between utility and non-utility businesses, it is prudent to minimize or avoid shared costs for personnel, facilities, services or construction. At the very least, the basis for the allocation of such costs should be documented clearly. Many companies have established separate corporate entities to differentiate their utility and non-utility businesses.

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This has been done by organizing utility and non-utility businesses as separate subsidiaries of an umbrella holding company.[4/] Alternatively, the non-utility business can be organized as a subsidiary of the utility itself.

Federal and state income tax payments are one of the cost components which have been extremely difficult to segregate even when a holding company or subsidiary corporate structure is adopted. A group of related corporations is often able to reduce its actual tax liability by filing a consolidated return rather than separate returns. When a consolidated return is filed, many jurisdictions have held that utility rates should be calculated on the basis of the utility's proportionate share of actual consolidated tax payments, rather than imputed tax payments, even if the reductions in the consolidated tax return result from non-jurisdictional activity. FPC v. United Gas Pipe Line Co., 386 U.S. 237, 246 (1967); City of Charlottesville v. FERC, 661 F.2d 945, No. 80-1175 (C.A.D.C. 1981); Mechanic Falls Water Co. v. Public Utilities Comm., 381 A.2d 1080, 1093 (S. Ct. Maine 1977). In addition, a large number of states have adjusted tax payments of local telephone utilities which are subsidiaries of large national systems to allocate to the local utility a proportion of the benefits of interest paid on debt incurred by the parent company. See New England Telephone and Telegraph Co. v. Public Utilities Co., 390 A.2d 8, 26-29 (S. Ct. Maine 1978) and cases cited therein. These adjustments may effectively reduce utility tax expenses allowed for rate-making purposes.

4/ This approach requires detailed consideration of the Public Utility Holding Company Act, 15 U.S.C. §79 et seq.

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B. Modification of Permitted Rate of Return to Reflect Non-Utility Operations

The Supreme Court's decisions in Bluefield Water Works and Improvement Co. v. P.S.C. of West Virginia, 262 U.S. 679, 692-693 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944), recognized the usefulness of the cost-of-capital approach to establishing a proper rate of return in utility rate regulation. However, a regulatory agency is not bound to any particular method of computing cost of capital or rate of return as long as the rate fixed is reasonable. When a utility is related to other non-utility or non-jurisdictional companies in a holding company or subsidiary relationship, many jurisdictions have inquired whether these other business activities affect the utility's cost of capital and have adjusted this cost to reflect the impact of affiliated non-utility operations for purposes of calculating the utility's permitted rate of return. For the most part, the authority to make these adjustments is based upon a commission's generic authority to provide for "just and reasonable" rates. In Potomac Edison Co. v. Public Service Commission, 369 A.2d 1035, 1040 (Ct. App. Md. 1977), the Maryland Court of Appeals stated that "[i]t is appropriate to consider the underlying capital structure of the system in any parent subsidiary situation." This statement is also made in Priest's treatise, Principles of Public Utility Regulation, (1969) p. 214. In a few jurisdictions, legislation explicitly authorizes the commission to inquire into and apportion capitalization, earnings and debt between a utility and related non-utility businesses. E.g., N.Y. Pub. Serv. Law §66(13), Mo. Rev. Stat. §393.140(12).

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It is important to note that a commission may generally ignore the relevance of a diversified affiliate when the utility's investment in the affiliate is small, but take cognizance of the affiliate when the investment grows. For example, the New York Commission recently stated in a decision regarding treatment of a gas exploration subsidiary for purposes of determining a utility's capital structure:

> In the past, the company's investment in non-regulated subsidiaries was small enough to be considered inconsequential for utility capitalization but, in light of the company's plans to diversify its operations extensively into areas beyond its gas distribution business, we must now look closely at the effect of subsidiary investments on its capitalization. The Brooklyn Union Gas Company, Op. No. 81-19, (N.Y. PSC, Oct. 21, 1981) pp. 35-36.

Similarly, the Michigan PSC did not adopt a consolidated capital structure for purposes of establishing rates for Consumers Power Company and its subsidiaries until Consumers created additional subsidiaries and the deferred taxes and undistributed retained earnings of its subsidiaries increased significantly. Re Consumers Power Co., Case No. U-5979 (Mich. PSC) p. 25.

Several different types of capital structure adjustments have been applied by commissions, each with its supporting rationale. One approach recommended in the 1972 National Association of Regulatory Utility Commissioner's Report of the Ad Hoc Committee on Non-Utility Investments is for a commission to eliminate all investments in non-utility businesses from the equity component of the consolidated company's capital structure. This approach generally assumes that the investment in the non-utility business is made by and is intended to benefit only the shareholders, and

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therefore should be attributed exclusively to shareholder equity. This approach may also assume that it is inappropriate to impute the cost of embedded regulated utility debt to the non-utility business.

The New York Public Service Commission adopted this approach in its recent decision involving an $18 million investment of the Brooklyn Union Gas Company (BUG) in Fuel Resources, Inc., a gas exploration subsidiary. Brooklyn Union Gas Co., Opinion No. 81-19, Case 27885 (N.Y. PSC, Oct. 20, 1981). The Commission rejected the recommendation of an ALJ and BUG that the subsidiary be deemed to have the same capital structure as BUG, stating that the subsidiary would not have been able to raise debt financing if it had been an independent exploration company. It also emphasized the importance of separating BUG's utility and non-utility operations and of insulating utility customers from risks which may be associated with non-utility ventures. The entire capitalization of the subsidiary was therefore subtracted from BUG's equity capitalization, thereby reducing BUG's permitted rate of return. This approach appears to be adopted most often by commissions when investment in non-utility businesses is relatively small.

Commissions generally adopt other adjustments to capital structure when a utility is a subsidiary of a larger holding company. These adjustments reflect concerns that a utility's capital structure is not an accurate reflection of its actual capital costs and are claimed to take into account the effective cost to the holding company of financing the stock of operating

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utility subsidiaries (Re Continental Telephone Co. of Minnesota, Inc., 14 PUR4th 310, 315 (Minn. PSC 1976)) or the actual cost of capital invested by shareholders of the parent company (Potomac Edison Co. v. Public Service Commission, supra. 369 A.2d at 1040).

In some circumstances, a commission allocates capital costs to a non-utility business in the same proportion as the capital structure of the overall consolidated company (i.e., the utility and non-utility businesses taken together). This approach has been applied to telephone, electric and water companies. Re Southern Bell Telephone and Telegraph Co., 35 PUR4th 1, 20-22 (So. Car. PSC 1980); Potomac Edison Co. v. Public Service Commission, supra., 369 A.2d at 1035; Mechanic Falls Water Co. v. Maine Public Utilities Commission, 381 A.2d 1080, 1095-1096 (S. Ct. Maine, 1977); Re Ohio Edison Co., 33 PUR4th 435, 469 (Ohio PUC 1980). Alternatively, particularly in telephone cases, a commission may apply a "double leverage" adjustment in which it adjusts a subsidiary's debt and equity to take into account the portion of the parent's debt which it believes is attributable to financing the subsidiary. See, e.g., United Telephone Co. of Iowa v. Iowa State Commerce Commision, 297 N.W.2d 466, 477-482 (S. Ct. Iowa 1977); Copland, Double Leverage One More Time, 100 Pub. Util. Fort. 19,

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20 (August 18, 1977); Brown, Double Leverage: Indisputable Factor or Precarious Theory? 93 Pub. Util. Fort. 26 (May 9, 1974).[5/]

Finally, many commissions have at times altered the capital structure of a regulated corporation for rate-making purposes to conform to hypothetical ratios or formulas. Comsat v. FCC, 611 F.2d 883, 904-905 (D.C. Cir. 1977), cites 23 jurisdictions which have made such adjustments. This flexibility may also enable regulatory commissions to effectively take cognizance of non-utility affiliates in this portion of the rate-making process. In People's Natural Gas Division of Northern Natural Gas Co. v. PUC, 567 P.2d 377, 380 (S. Ct. Colo. 1977), the Court held that the Commission could "pierce corporate structures of corporations which also operate non-utility divisions or subsidiaries to impute a capital structure for the utility operation which is reflective of the capitalization actually backing the utility operation," even though it otherwise generally disapproved of the use of hypothetical capital structures in ratemaking.

In summary, even when a commission lacks direct authority to regulate a non-utility business which is related to, but organizationally separate from, a utility, the commission may take some cognizance of the non-utility business in a portion of the rate-making process.

5/ Other states which have implemented this adjustment include Minnesota (Re Continental Telephone Co. of Minnesota, Inc., 14 PUR4th 310, 316 (Minn. PSC 1976)), Montana (Mountain States Telephone and Telegraph Co. v. Department of Public Service Regulation, 624 P.2d 481 (S. Ct. Mont. 1981)), New Jersey (Re United Telephone Co. of New Jersey, 2 PUR4th 299, 308 (N.J. PUC 1974)); New York (Re Midstate Telephone Co., Inc., 10 PUR4th 88, 95-96 (N.Y. PSC 1975)), Rhode Island (Blackstone Valley Electric Co., 24 PUR4th 309, 321-23 (R.I. PUC 1978)). Authorities disagree whether these adjustments are appropriate where a parent company holds most, but not all, of the subsidiary's stock. New England Tel. & Tel. Co. v. PUC, 390 A.2d 8 (S. Ct. Maine 1978).

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III. FINANCING RESTRICTIONS

The extent to which a state regulatory body may exercise authority over the financing and securities aspects of a public utility business is an important consideration prior to undertaking a diversification program. Most states have statutes which may pose restrictions on a utility's ability to issue securities to finance investments in diversified businesses, to make loans or other cash advances to a non-utility subsidiary, or to pay out dividends to its shareholders. This section will briefly identify such statutory provisions. The next section discusses the potential relevance of state regulation of and restrictions on utility corporate reorganizations intended to facilitate diversification.

Utilities are generally required by statute to apply for and obtain the approval of the state utility commission to issue stocks, bonds, notes or other evidences of indebtedness. E.g., La. Rev. Stat. Ann. §45-1168; 135 Me. Rev. Stat. §171 et seq.; Va. Code §§56-55 to 56-75; Mich. Stat. Ann. §22.101. The statutes are generally applicable only to securities or other forms of debt of greater than a twelve month maturity. Securities payable within periods of not more than twelve months usually can be issued without a commission order. Idaho Code §61-903; 35 Me. Rev. Stat. §171. A small number of states such as Iowa and Mississippi do not explicitly regulate the issuance of securities by public utilities. In these states the provisions of federal laws such as the Federal Power Act may be applied.

Generally accompanying state commission authority over the issuance of securities is authority for the commission to conduct investigations, hold hearings and examine utility records to

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determine whether the security issuance should be approved. 35 Me. Rev. Stat. §171. Certain states permit interested persons to intervene in proceedings to determine if the corporation may issue such securities. Mich. Stat. Ann. §22.101.

Generally, state statutes specify the purposes for which such securities and other forms of indebtedness may be issued. Permissible purposes may include the acquisition of property; the construction, completion, extension or improvement of utility facilities; the improvement or maintenance of service; or the discharge or lawful refunding of obligations.6/ A number of statutes also contain a general purpose clause such as "for any other lawful purposes," 35 Me. Rev. Stat. §171, or for "any purpose approved by the commission." Mont. Rev. Codes Ann. §69-3-501(f). The scope of a commission's

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6/ One example is Section 817 of the California Code, which provides:

Purposes for issuance of securities

A public utility may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others;

(a) For the acquisition of property.

(b) For the construction, completion, extension, or improvement of its facilities.

(c) For the improvement or maintenance of its service.

(d) For the discharge or lawful refunding of its obligations.

(e) For the financing of the acquisition and installation of electrical and plumbing appliances and agricultural equipment which are sold by other than a public utility, for use within the service area of the public utility.

(f) For the reorganization or readjustment of its indebtedness or capitalization upon a merger, consolidation, or other reorganization.

(Footnote continued on next page.)

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inquiry in determining whether to grant approval may vary considerably depending upon the jurisdiction involved. The Michigan Supreme Court in Attorney General v. Michigan Public Service Commission, Docket No. 67938, et al., (S. Ct. Mich., January 27, 1981), recently upheld a Public Service Commission ruling that a securities issuance proceeding was limited to an inquiry regarding whether funds were to be applied for "lawful purposes" such as power plant construction. That case arose after Detroit Edison and Consumers Power had requested the Michigan PSC to approve a normally routine securities issuance to finance continuing construction programs. The state attorney general sought to block approval by claiming that the utilities were financing the construction of unneeded power plants. The Court held that the Commission has no discretion in a securities proceeding to evaluate the need for a particular construction project. Its opinion contains an extensive discussion of the manner in which a number of securities provisions have been interpreted in other states and concludes that such statutes are "susceptible to expansive as well as narrow statutory interpretations." Id. at 11.

(Footnote continued)

(g) For the retirement of or in exchange for one or more outstanding, stocks or stock certificates or other evidence of interest or ownership of such public utility, or bonds, notes, or other evidence of indebtedness of such public utility, with or without the payment of cash.

(h) For the reimbursement of monies actually expended from income or from any other money in the treasury of the public utility not secured by or obtained from the issue of stocks or stock certificates or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness of the public utility, for any of the aforesaid purposes except maintenance of service and replacements, in cases where the applicant had kept its accounts and vouchers for such expenditures in such manner as to enable the commission to ascertain the amount of money so expended and the purposes for which such expenditure was made.

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It is also relevant to consider whether or not a particular utility is permitted by statute to use money from revenues, retained earnings or a securities issuance to invest directly or indirectly in another corporation. A few states maintain some restrictions. For example, Section 27(g) of the Illinois Public Utilities Act states:

> Unless the consent and approval of the Commission is first obtained or unless such approval is waived by the Commission in accordance with this Section:
>
> * * *
>
> (g) No public utility may use, appropriate, or divert any of its monies, property or other resources in or to any business or enterprise which is not, prior to such use, appropriation or diversion essentially and directly connected with or a proper and necessary department or division of the business of such public utility...

In People v. Phelps, 67 Ill. App. 3d 976, 385 N.E.2d 738 (1978), a water utility and its chief executive officer was found to have violated Section 27(g) and other portions of the Illinois code. The case involved an arrangement between the water utility and its holding company whereby funds from more than $1 million short-term loans were transferred from the utility to the holding company. The Court held that the transfer violated §27(g) because the holding company was involved in investments, many of which were highly speculative, which had absolutely no connection with the business of the water utility.

Similarly, Section 107 of New York Public Service Law states:

> §107. Approval of the use of revenues
>
> Except with the consent and approval of the public service commission first had and obtained, no public utility shall use revenues received

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> from the rendition of public service within the state for any purpose other than its operating, maintenance and depreciation expenses, the construction, extension, improvement or maintenance of its facilities and service, the payment of its indebtedness and interest thereon, and the payment of dividends to its stockholders.

Section 107 has been interpreted to "include all utility funds in any way associated with public service." Pub. Serv. Comm. v. Rochester Telephone Corp. 440 N.Y.S.2d 378 (App. Div. 1981). Thus, the investment of utility earnings in non-utility businesses is subject to prior commission approval under Section 107.

In June of 1980, the New York State legislature modified this requirement by enacting Section 66-c. Section 66-c of the Public Service Law authorizes a gas, electric or steam corporation, upon 45 days written notice to the Public Service Commission to establish and finance out of retained earnings (unless the Commission shall find that such financing may affect the Corporation's ability to provide safe and adequate service at just and reasonable rates) a subsidiary corporation whose sole purpose is the ownership and/or operation, in whole or in part of one or more co-generation, small hydro or alternate energy production facilities. Section 66-c also provides that such subsidiaries shall be exempt from regulation by the Public Service Commission. A number of electric utilities in New York have established cogeneration subsidiaries pursuant to this provision.

Another factor that should be considered is whether the state commission has authority to restrict the declaration of dividends by a utility. Some states, like Maine, explicitly provide that no public utility "shall decrease its capital or declare any bond or

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scrip dividend ...among stockholders, without the consent of the commission." 35 Me. Rev. Stat. §174. Other state commissions, like California's, which lack this explicit statutory authority have interpreted their general statutory powers to include the authority to restrict the dividends of a utility. The California Public Utilities Commission in California-American Water Company, Decision No. 86807, 81 PUC 204, 242 (1977) ordered Cal-Am, a wholly-owned subsidiary of holding company American Water Works Co., to restrict payments of dividends to American Water Works until such time as the Commission finds it prudent to permit payment. The Commission found that Cal-Am had failed in its public utility obligation to maintain the reasonable level of service required by the Public Utilties Code. The failure was found to be the direct result of the utility's payment of excessive dividends to the holding company which in turn restricted Cal-Am's ability to finance and construct adequate facilities. Moreover, these policies directly contradicted assurances American Water Works had given to the Commission when it was permitted to acquire Cal-Am. The Commission appears to have recognized that this case involved unusual circumstances for it indicated that the authority to restrict dividends was to be discretely applied only when considered "in the context of the entire record." Id. at 239. The implication is that such authority was not to be routinely exercised.

This brief discussion of statutory provisions regarding securities and financing matters demonstrates that most states have the potential to affect the financing of non-utility investments or the structure under which such investments can be made. The extent and significance of regulatory involvement varies from state to state. Therefore, a thorough examination of potentially relevant laws is required for each applicable jurisdiction.

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IV. CORPORATE REORGANIZATION

This portion of this study looks at the role public utility commissions may play before the fact in corporate restructuring which may precede or accompany diversification into new non-utility business ventures. It addresses state commission oversight and asserted authority to approve the formation of holding companies as the vehicle to provide corporate and financial flexibility for implementing diversification.

Because utility diversification has until recently been such a "non-traditional issue"[1/] for public utility commissions, few are vested with explicit statutory authority to address the issues raised as thoroughly as they might wish. As the prospect of utility diversification becomes a reality in more states, and the issues inherent in such ventures become more apparent to regulators and the public, some commissions are attempting to flex regulatory muscle which may not in fact exist. Where the statutory framework does not exist, increased legislative activity is possible.

Commission attitudes regarding and roles in utility diversification reorganizations vary from state to state. Some state statutes require commissions to approve at least certain types of reorganizations. Cal. Pub. Util. Code, §854; Mass. Ann. Laws Ch. 169, §96. In the absence of explicit statutory direction to do so, some commissions have not regulated the formation of new corporate

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1/ Edward F. Burke, "Regulatory Issues in Diversification," Utility Diversification, Strategies and Issues, 194 (1981). Mr. Burke at the time of the quoted remark was Chairman, Rhode Island Public Utilities Commission and President of NARUC.

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structures that may facilitate diversification. Some of these commissions might be characterized as preferring to regulate diversification business ventures after-the-fact through limited but long established authority over affiliated transactions, ratemaking, dividends and similar regulatory measures. In such states corporate executives must be cognizant of issues discussed elsewhere in this study in order to judge whether planned diversification will accomplish the objectives sought.

Given the many issues raised by utility diversification programs, some state commissions have asserted jurisdiction over the formation of new corporate structures such as holding companies, even in the face of questionable statutory authority. Commissions may be motivated by their perceived responsibility to see that the delicate balance between benefits to stockholders and to consumers is maintained by a utility's diversification plans.[8/] They also may do so because of the policy position taken in November 1980 by the National Association of Regulatory Utility Commissioners:

> 18. Diversification of Utilities and Carriers. Utilities or carriers should not be encouraged to diversify into unrelated non-utility or non-carrier operations in order to assure that the full resources of management are devoted to public service.[9/]

Whatever the reason for commission involvement, utility company executives face the greatest uncertainty in states which choose for the first time to regulate the formation of new corporate structures in the absence of clear statutory authority. Prior

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8/ Id. at 206.
9/ Id. at 195.

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inactivity before-the-fact by utility commissions concerning corporate restructuring cannot be taken as assurance of future behavior. As will be seen, some commissions have only lately begun to recognize some role for themselves at this stage and have attempted to base their jurisdiction on whatever statutory authority exists.

A few examples of what has occurred in some states in terms of before-the-fact regulatory oversight will alert utility corporate planners to the kinds of statutory authority used by commissions as a basis for their jurisdiction. In some instances utility companies are acknowledging commission jurisdiction; in others a company may acquiesce even though jursidiction may be questionable. Finally, in at least two states, Illinois and Wisconsin, utilities have questioned or are questioning the commission's jurisdiction.

In Massachusetts, Boston Edison Company ("Edison") is seeking approval of a reorganization plan from the Massachusetts Department of Public Utilities ("MDPU"). This plan is representative of many holding company reorganizations. Under the reorganization, Edison would become a wholly-owned subsidiary of Boston Industries ("Industries"), a business trust. A third entity, BECO Electric Company ("BECO"), a recently organized electric company, is involved in the restructuring. Industries and BECO were formed solely for the purpose of taking part in the restructuring. Industries would be established initially as a wholly-owned subsidiary of Edison. Following MDPU approval, BECO will issue stock to Industries. Edison will then merge with BECO, the survivor, Edison, becoming a wholly-owned subsidiary of Industries. Common stock of Industries will be distributed to Edison's stockholders in exchange for Edison common stock.

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Based upon this restructuring plan, Edison has acknowledged MDPU's jurisdiction under Sections 14 and 96 of Chapter 164 of the Massachusetts General Laws. Mass. Ann. Laws Ch. 164, §§14, 96. Section 14 addresses issuance of stock by an electric company, BECO under this reorganization. It provides, in pertinent part:

> [E]lectric companies shall issue only such amount of stock... as the department may from time to time vote is reasonably necessary for the purpose for which issue of stock...has been authorized.

Section 96, which concerns consolidations and mergers of companies subject to the requirements of Chapter 164, provides, in pertinent part:

> Companies subject to this chapter may... consolidate or merge with one another... provided that... the department, after notice and a public hearing, has determined that such... consolidation or merger, and the terms thereof, are consistent with the public interest.

Under this restructuring proposal, Edison and BECO are both subject to Chapter 164 and their merger must be approved by the MDPU after a determination that it is consistent with the "public interest". This is the primary substantive issue which must be resolved by the MDPU. If the MDPU finds the merger to be in the public interest, then the issuance of stock by BECO will be "reasonably necessary for the purpose... authorized," thereby satisfying Section 14.

Hearings under Section 96 are in progress before the MDPU. The Massachusetts Attorney General and the City of Boston have intervened. Intervenors are expressing a variety of concerns focused on the continued financial health of Edison under the reorganization. On February 1, 1982, Edison and BECO filed a brief with the Department discussing the meaning of the public

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interest finding. Under applicable case law Edison has argued that it merely has to show that the restructuring would not be inimical to the public interest. Boston Consolidated Gas Company, 100 PUR(NS) 65, 67 (1953). To do this it responds to the allegations of potential dangers raised by the intervenors.

In Hawaii, Hawaiian Electric Company, Inc. ("Heco") and Hawaiian Electric Industries, Inc. ("Industries") filed on July 29, 1981, an application with the Public Utilities Commission for authority to merge New Heco, Inc. (a new corporation to be formed by Industries as a merger vehicle) into Heco and for authority for Industries to own all the common stock of Heco. In the merger the common stock of Heco would be changed, on a share-for-share basis, into common stock of Industries. Heco's two existing electric utility subsidiaries would remain subsidiaries of Heco.

Heco is seeking the Commission's approval under sections of the Hawaii statute dealing with issuance of securities (Hawaii Rev. Stat. §269-17, Commission approval required for issuance of securities for stated purposes only) and merger and consolidation of public utility corporations (Hawaii Rev. Stat. §269-29, §417-10, Commission approval required for disposal of property or to merge or consolidate with another utility.) Heco also seeks the Commission's approval of Industries' ownership of all of the issued and outstanding common stock of Heco under Section 269-17.5, which requires Commission approval for any person to hold more than 25% of issued and outstanding voting stock of a public utility. In addition to the State Public Utilities Commission approval, Heco will need the approval of the SEC under Section 9(a)(2) of the Public Utility Holding Company Act of 1935.

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The manner in which the Public Utilities Commission will assert jurisdiction over Heco's reorganization remains to be seen. However, the Commission's 1971 decision regarding a gas company's reorganization may give some clue. In 1971, the Hawaii Public Utilities Commission approved a plan of reorganization and agreement of merger of Honolulu Gas Company, Ltd, involving the formation of a holding company. Decision and Order No. 2762, May 27, 1971. The Commission found that the reorganization and agreement of merger did not appear to be detrimental to the public interest nor to the utility's financial condition and ability to continue its public utility operations. Nevertheless, the Commission felt constrained to incorporate in the Order 22 conditions which set forth procedures and guidelines purporting to safeguard the continuing integrity of the utility operation. These conditions establish the continuing regulatory power of the Commission over the utility operations and all transactions between the utility and affiliated corporations. The conditions include provisions governing access to records, allocation of expenses, classification of plant, dividends, financings, transactions between affiliates and other issues. The Hawaii Commission's authority to impose these conditions was not appealed.[10/]

10/ For a similarly pervasive order in another jurisdiction see, Southern Connecticut Gas Co., Decision, Docket No. 770828 (Conn. PUCA, December 13, 1978).

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The Hawaii Commission's jurisdiction over utility diversification would be strengthened by enactment of a bill which has just been introduced in the current session of the Hawaii legislature. The bill would require Commission approval of any solar energy business pursued by a public utility or public utility (affiliate).

In Illinois the extent of the Illinois Commerce Commission's jurisdiction over utility reorganization is unsettled due to pending litigation over the recently completed reorganization of Peoples Energy Corporation ("PEC"). However, the history of this reorganization to date is instructive. The Board of Directors of PEC had approved a plan of reorganization whereby two independent holding companies would be formed. All of PEC's non-utility subsidiaries were to become subsidiaries of a new holding company, MidCon Corporation ("MidCon"). PEC would continue to exist as a holding company with two utility subsidiaries, the Peoples Gas Light and Coke Company and North Shore Gas Company, over which the Commission had jurisdiction. The reorganization had been carefully structured to be accomplished with the minimum of regulatory approvals, and particularly to avoid the need for Illinois Commerce Commission approval.

Some time after the Illinois Commission was notified that Peoples Energy Corporation was proposing to divest itself of all but its utility subsidiaries, the Commission issued a citation order on July 22, 1981 to Peoples and its subsidiaries. The companies were required to show cause why the divestiture was not subject to the jurisdiction of the Commission.

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The Commission asserted jurisdiction pursuant to Sections 8, 8a, 21, 22 and 27 of the Illinois Public Utilities Act. Ill. Ann. Stat. Ch. 111 2/3, §§8, 8a, 21, 22, 27. Section 8 gives the Commission general supervision over all public utilities; Section 8a confers authority over affiliated interests; Section 21 requires Commission approval over the issuance of securities for stated purposes only; Section 22 confers authority over mergers, consolidations and reorganizations with respect to capitalization; and Section 27 restricts intercorporate transactions covering property, securities, loans, and similar matters.

In a memorandum of law filed with the Commission pursuant to its citation order of July 22, 1981, PEC took the position that merely because of its ownership of the securities of a public utility, it was not a public utility as defined by the Illinois statute (Ill. Ann. Stat. Ch 111 2/3, §10.3) and, therefore, was not within the jurisdiction of the Illinois Commission. PEC argued that it did not qualify as a "public utility" because it did not own, control, operate or manage the physical plant through which utility service was supplied or the licenses or franchises under which the public utility business was pursued. PEC asserted that on prior occasions the Commission had characterized PEC as an affiliated interest subject to regulation under Section 8a(3).

Looking at the Commission's jurisdiction over affiliated interests, PEC interpreted Section 8a of the Illinois statute to limit the Commission's jurisdiction to having access to accounts and records of the affiliated interest as such related to transactions occurring with the public utility. Transactions were viewed as

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requiring some actual transfer of goods, services or funds between the utility and its affiliated interest. PEC argued that its reorganization involved no "transaction" as used in Section 8a(3) between a utility and an affiliated interest.

As to the Commission's assertion of jurisdiction under Section 21, concerning the issuance of securities by a public utility, PEC asserted that Section 21 had no relevance. The reorganization involved no issuance or transfer of securities by a public utility since PEC was not an utility. PEC's two utility subsidiaries were not affected by and issued no securities in connection with the reorganization. The only securities issued were issued by MidCon, the new holding company with non-utility subsidiaries resulting from the reorganization. MidCon had no attributes whatsoever of a public utility holding company, much less a public utility, that would make it subject to Section 21.

The Commission also asserted jurisdiction under Section 22, regarding the "capitalization of a public utility formed by a merger or consolidation of two or more corporations" and the issuance of securities in connection with the "reorganization of a public utility, resulting from forced sale, or in any other manner." (Emphasis added.) PEC argued that this section did not confer jurisdiction on the Commission because no merger or consolidation resulting in formation of a public utility was involved. Furthermore, no securities were to be issued by a public utility. The only entitites being formed or reorganized were PEC and MidCon, neither of which was a public utility.

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The Commission's assertion of jurisdiction under Section 27 of the Illinois statute rested upon a finding of transactions between two or more public utilities. PEC argued, however, that the reorganization involved no transactions between or among public utilities.

The final word concerning the Illinois Commerce Commission's jurisdiction over PEC's reorganization has not yet been heard. On October 23, 1981, Judge George J. Schaller of the Cook County Circuit Court granted PEC's motion for a preliminary injunction preventing the Commission from asserting jurisdiction to approve the merger. Peoples Energy Corporation v. Illinois Commerce Commission, No. 81 CH 6768, (Cir. Ct. Cook County Ct., Ill. October 23, 1981). Judge Schaller's 54 page Findings of Fact, Conclusions of Law and Order sustained PEC's basic arguments concerning the Commission's lack of jurisdiction. He found that neither of the two holding companies, PEC or MidCon, was a public utility under the statutory definition in Section 10.3. Neither engaged in any activities that would render it a public utility. PEC never managed directly or indirectly the utility activities of its two utility subsidiaries. Its relationship with its subsidiaries was merely advisory. No line functions were performed by PEC. As a financial holding company, PEC owned no assets that were devoted to public use. MidCon could not be considered a public utility for essentially the same reasons.

Once Judge Schaller found that PEC and MidCon were not public utilities, the other bases for the Commissions assertion of jurisdiction, which all hinged upon public utility involvement, fell. For instance, although the Court agreed that PEC was an affiliated

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interest under Section 8(a), the Commission's jurisdiction was limited to transactions between a public utility and an affiliated interest. The Court found that such transactions were not involved in the reorganization.

The case is still pending before Judge Schaller on PEC's motion for a permanent injunction. Unless the case is settled, Judge Schaller's decision on the permanent injunction, after review of the case on the merits, will be a precedent for future utility reorganizations in the state. To the extent that PEC's arguments prevail, PEC will have demonstrated the value of a carefully structured reorganization formulated with a clear understanding of the limitations of existing Commission authority. PEC's arguments could well apply in other states with similar statutory provisions.

Finally, the Public Service Commission of Wisconsin represents a good example of a commission, until recently largely inactive in before-the-fact regulation of utility diversification, which has thoroughly investigated the extent to which it should assert itself in this area. It has been in the forefront of commission efforts throughout the country to oversee and approve the formation of holding companies for purposes of diversification.

In mid-1981 the Commission played a largely inactive role when Wisconsin Gas Company created a holding company which owned the stock of the gas utility. The holding company was created in order to permit diversification into non-utility businesses.[11/]

11/ The Commission's proposed rule, however, appeared to require Wisconsin Gas Company to apply to the Commission for approval of the reorganization which has already occurred.

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It appears that both the Commission and the company at the time felt that the Commission did not have jurisdiction over such a reorganization.[12/]

In the fall of 1981, however, Wisconsin Power & Light Company and Wisconsin Electric Power Company both filed applications with the SEC pursuant to the Public Utility Holding Company Act of 1935 requesting approval for the formation of holding companies. In connection with these applications the SEC sought the views of the Wisconsin Public Service Commission.

The SEC request stirred the interest of the Commission. Based on a two-to-one vote, the Commission decided to assert jurisdiction over the actual formation of the holding companies and so notified the SEC. On December 1, 1981, a notice of hearing was signed soliciting comments on a proposed rule governing the reorganization of public utilities to form holding companies for purposes of diversification into non-utility business and investments. A hearing on the proposed rule was held on January 25, 1982.

The Commission cited as authority for the proposed rule, statutory provisions pertaining to corporate reorganizations and giving the Commission comprehensive authority to regulate issuance of securities by utilities. Wisc. Stat. Ann. §§184, 169.79. The purpose of the proposed rule was to govern all reorganizations of public service corporations creating and terminating holding companies.

12/ Response to EEI Business Diversification Legal and Regulatory Survey.

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The proposed rule required written approval of the Commission for the reorganization of a public utility intended to create or terminate a holding company. A certificate was required to transfer, exchange, modify, cancel or convert any securities of a public service corporation to affect a reorganization which created or terminated a holding company or created or terminated a subsidiary. The applicant was to show that the reorganization was in the public interest and, in order to obtain a certificate, that the financial condition, plan of operation and proposed undertakings of the holding company, subsidiary companies and the public service corporation would afford reasonable protection to investors in their securities.

Under the proposed rule, some of the factors that the Commission would have considered in reviewing a proposal to diversify included:

[1] The risks and benefits of non-utility investments of a holding company to the public utility's ability to deliver adequate service at reasonable rates.

[2] The allocation of management and personnel between the public utility subsidiary company and the holding company and non-utility subsidiary companies.

[3] The effect on management and operation of utility in general.

[4] The allocation of income, losses, costs and expenses among the holding company and its public utility and non-utility subsidiaries.

[5] The effect of the plan of reorganization on the capital structure of the public utility.

* * *

[6] The effect the plan of reorganization may have on the ability of the commission staff to monitor the effect of non-utility investments on the public utility.

[7] A showing that the plan is consistent with the public interest.

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The proposed rule authorized the Commission to monitor the continuing impact of the plan of reorganization on the utility company. If the Commission determined that the continuing impact of the plan was inconsistent with the public interest, the Commission could have required the termination of the holding company or a divestiture of such non-utility investments or businesses as might be necessary to protect the public interest.

Another provision of the proposed rule subjected the issuance of securities by the holding company and any subsidiary to approval by the Commission to the same extent as securities of the public service corporation. The holding company and any non-utility subsidiary were considered "an affiliated interest" for purposes of regulation by the Commission under the affiliated interest statutory provision. The proposed rule gave the Commission authority to prohibit payment of dividends by the holding company or any subsidiary company if the Commission found that the capital of the holding company might be impaired by the issuance of the dividend. Payment of dividends could also have been prohibited if payment was found to be unreasonable, taking into consideration the overall impact to the public interest, the interest of the investors in the securities, the past practices and policies of the business and the policies and practices of comparable businesses. Finally, the proposed rule had retroactive effect by requiring any holding company or subsidiary company in existence on the effective date of the rule to file an application for approval and certificate as required in the regulations.

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On March 19, 1982, the Wisconsin Commission voted to modify its position regarding utility diversification and withdrew the proposed rule. The Commission determined that utilities are authorized to diversify by forming holding companies which are not subject to Commission jurisdiction as public utilities. However, the Commission held that it maintains jurisdiction over the formation of a holding company. On April 13, 1982, the Commission released revised proposed rules implementing the Commission's March 19 decision. Under these rules, a utility seeking to form a holding company would be required to obtain Commission approval prior to filing any application, registration, prospectus or other statement with a court, the SEC, FERC or other federal or state administrative agency. The application for approval would be required to detail the plan of reorganization, the purposes of and reasons for reorganization, the impact of reorganization on the financial structure of the utility and upon utility service and other information. The proposed rule provides that the Commission must find the plan of reorganization is "consistent with the public interest," a standard which primarily requires a showing that ratepayers would not be harmed by the reorganization. The Commission retains the authority to limit the proportion of the assets of the holding company devoted to non-utility uses. The proposed rule also requires the holding company to make its books, records and officers available for Commission review. The rule would be applied to utility reorganizations which took place in the past. The Wisconsin Commission is requesting additional comments on these revised rules and has scheduled hearings for May 12, 1982.

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The outcome of this rulemaking and any ensuing litigation which may challenge the Commission's jurisdiction is important in its own right. Added significance attaches to it, however, because the Wisconsin Public Service Commission chairman, Stanley York, is heading up the National Association of Regulatory Utility Commissioner's Ad Hoc Committee that is preparing a report on utility diversification. What happens in Wisconsin may well find its way into NARUC's Report on utility diversification and, in turn, may be reflected in positions taken by other state utility commissions. Meanwhile, the applications of Wisconsin Power and Light Company and Wisconsin Electric Power Company to the SEC for creation of holding companies await the outcome of the Wisconsin Commission's proceedings.

In addition to the examples discussed above, companies in several other states are involved in corporate reorganizations as well. There is a distinct pattern of commissions becoming increasingly interested in regulating such reorganizations before they occur. However, except for those states where statutory authority is explicit, the source, scope and extent of commission authority to regulate such reorganizations, if any, are far from resolved.

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CONCLUSIONS

There are no definitive legal answers equally applicable to all states for many of the questions which corporate executives commonly raise about the effect of state laws and regulatory practices on utility diversification activities. State laws, regulatory practices and regulatory climates vary with each jurisdiction. Many of the relevant statutes are extremely vague and are susceptible to a variety of interpretations. As we have shown above, public utility commissions which have never previously regulated utility diversification activities and which desire to control such activities may seek the authority to do so on the basis of such ambiguous authority. This could engender considerable litigation.

It is not always possible to predict how or when a commission might initiate such an attempt. Perception of a threat from utility diversification, a change in political climate, perceived trends initiated by other commissions or other factors could instigate a commission to attempt to expand the scope and extent of its authority. These events could also cause a state to pass new laws explicitly authorizing expanded commission jurisdiction even when a commission does not otherwise plan to become involved. The State of New Mexico, for example, recently imposed a 15 month moratorium on utility diversification and directed its commission to develop rules regarding this issue. To some observers the repeal of the Public Utility Holding Company Act, if it occurs, could similarly cause states to modify their laws to provide their commissions greater regulatory control of utility holding companies and their subsidiary businesses.

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Under these circumstances, it is essential for utility executives to be aware not only of the laws and regulatory practices which currently exist in the jurisdictions in which they operate, but of other practices and activities which could potentially provide a basis for regulatory involvement as well.

We have attempted to show some of the circumstances under which such regulatory involvement has occurred in the past and could occur in the future and the potential consequences of such involvement. There is always the potential for regulatory involvement over affiliate transactions. The consequences of such involvement may vary from limiting an affiliate to a utility rate of return to permitting it to earn a return as dictated by arm's-length market transactions. While many non-utility affiliates operate free of regulatory control, it may be important to clearly separate non-utility operations since where separation has not been clearly established, considerable confusion and litigation has resulted in many instances. In addition, securities statutes are relevant to the choice of mechanisms for financing non-utility affilates and to utility reorganization plans. Finally, even when a non-utility affiliate is established and is otherwise free from regulatory control, commissions may take cognizance of such activities in reviewing cost allocations, in establishing utility capital structures or other calculations used in computing the regulated utility's permitted rate of return and in determining the proper allocation of federal income taxes and similar expenses.

It is essential to repeat our initial admonition that a broad survey such as this can not adequately identify the current state of the law and regulatory practices in each state, let alone predict how regulatory practices may develop in response to various utility diversification strategies. Each utility contemplating diversification obviously must conduct a detailed analysis of the laws and practices of the jurisdictions in which it operates in light of its regulatory climate and contemplated activities.

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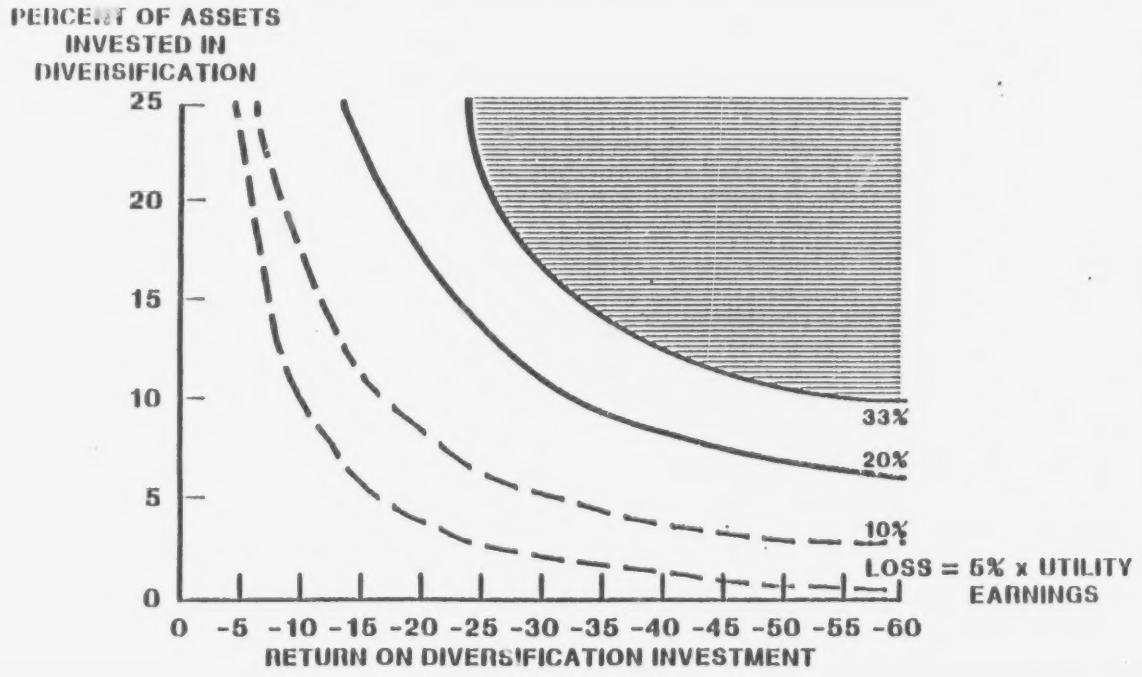
APPENDIX B

RISK OF EARNINGS ATTRITION



Source: Planmetrics Inc., Electric Utility Diversification: Simulation of Financial and Economic Impacts, prepared for EEI, January 1982.

Mr. SWIFT. Thank you very much, Mr. Nichols.

I will call on Alan H. Richardson of the American Public Power Association.

STATEMENT OF ALAN H. RICHARDSON

Mr. RICHARDSON. Thank you, Mr. Chairman.

I would like to start by identifying the context within which this whole act must be reviewed. It seems to me that there are two critical elements in the whole issue of the Holding Company Act debate. The first is that we are dealing with a public business regardless of whether it is private or public. It is essential to public health, life, and economic survival. Second, the electric utility industry operates under monopoly conditions. When you have the combination of these two factors, an essential service and a monopoly, you have a business which is affected by the public interest, and that business is itself public and not private.

Competition does regulate free enterprise by free choice in the marketplace exercised daily by individual consumers.

And they determine which companies will survive, which will prosper, and which won't. With the exception of a very few communities, there is no free choice for electric power supply. Electric companies are granted an exclusive franchise. If you want to turn on your lights you have only one electric company available. Because of this, Government regulation is set up to act as a substitute for competition. It sets rates and takes other actions to protect investors and consumers alike.

Now I don't think you would dispute today that the Holding Company Act was absolutely necessary to protect investors, and consumers, and the public when it was passed in 1935, although there was a very heated debate in 1935 about whether the act was appropriate and whether it should be passed. It was one of the hardest fought legislative battles in the century. But since then the industry has been restructured and holding company empires which controlled over 85 percent of the utility industry have today been broken up. So today we have only nine registered electric utility holding companies, and these represent as we have been told only 21 percent of the utility industry.

This is a very significant percent of a very large industry representing imbedded assets of many billions of dollars and annual revenues of many, many billions of dollars.

The registered companies and the exempt companies and those who choose not to form holding companies, because they would become subject to the act, seek substantial modification or better yet, repeal of the act. There are many arguments which they have advanced in favor of repeal or modification of the act and these are all set forth in my testimony. Our views with respect to those arguments are also set forth.

There is one issue, however, which I don't think has been completely addressed in other testimony, and that is the protections that are afforded by the act in the areas of merger and promotion of competition in the electric utility industry. We look out over the industry today, and we see calm waters, and perhaps we fail to realize that those calm waters are because back in 1935 we construct-

ed a dam, which as a result has created those calm waters. In the past few years, however, the act has been very important in protecting consumers, and in protecting the public.

I have a letter which I would like to submit for the record, which sets forth a number of instances in which the act has been used to the benefit of the public in general and the benefit of public power systems in particular, and I would like to ask that that letter be inserted in the hearing record.

Mr. SWIFT. Without objection, it will be included following your statement.

Mr. RICHARDSON. If I may, I would like to identify a few of the instances which are listed in this letter to me. The letter is from George Spiegel of the law firm of Spiegel & McDiarmid, and I will quote a bit from this letter:

"A good example of the" importance of the act is the "comparatively recent disapproval" by the SEC "of the proposed Eastern Electric Energy merger. The New England Electric System, Boston Edison Co., and Eastern Utilities Associates proposed to merge. After proceedings in which the antitrust division of the Justice Department was a party, the SEC * * * ruled that the proposed merger would not serve the public interest by tending toward the economic and efficient development of an integrated public utility system * * * the SEC ruled that consolidated operation of these three large holding companies would not yield operating efficiencies sufficient to meet the standards of the act."

The SEC found that all of the benefits which were attributed to the merger "were available through power pooling. In the context of the * * * merger, the SEC concluded that the New England Power Pool offered the New England region all of the benefits of economies of scale in the generation and transmission of power with none of the burdens to the consumer resultant from the affiliation and its attendant corporate growth."

Another example—The acquisition by the American Electric Power Co. of the Columbus and Southern Ohio Electric Co. Again the Antitrust Division of the Department of Justice participated in this proceeding, and the SEC staff and the Department of Justice opposed the merger, on the grounds that it would violate the policies of the antitrust laws which are embraced by the public interest standards of the Holding Company Act.

The Ohio Municipal Electric Association intervened in the proceeding as well and asserted that the merger would adversely affect competition in the bulk power market in Ohio to their detriment. As a result of these proceedings, a settlement was finally reached under which the merger was permitted, but the Ohio municipalities were protected in their access to bulk power.

A final example, which I will relate here, although there are others in the letter, concerned a merger creating Northeast Utilities. The merger itself was approved, but very significantly it was conditioned on Northeast Utility's assurance of a high voltage interconnection between one of its operating companies and the city of Holyoke Gas and Electric Department. The SEC ordered Northeast Utilities to give Holyoke access in addition to the Connecticut Valley Electric Exchange.

Previously, Holyoke was an isolated electric utility system and subject to continued takeover attempts by investor-owned utilities. Since the merger, and since the interconnection and the entrance of that system into the Connecticut Valley Electric Exchange, Holyoke has enjoyed excellent financial health. The takeover efforts have ceased, and Northeast Utilities has benefited businesswise from its transactions with Holyoke.

These, Mr. Chairman, are benefits which we believe accrue both to the public and to the public power systems in particular from provisions of the Public Utility Holding Company Act.

As I mentioned, we do have some very strong feelings about utility diversification, and its possible impact on us as major power purchasers, and those views are set forth in my prepared testimony. Thank you very much.

[Testimony resumes on p. 470.]

[The prepared statement and attachments of Mr. Richardson follow:]

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Statement of
Alan H. Richardson
Legislative Director and Counsel
American Public Power Association

on the

Public Utility Holding Company Act of 1935

Presented to the
Subcommittee on Energy Conservation and Power
House Committee on Energy and Commerce

June 9, 1982

Mr. Chairman, members of the Subcommittee, my name is Alan H. Richardson. I am the Legislative Director and Legislative Counsel for the American Public Power Association. APPA is the national service organization representing over 1,750 local public power systems in 48 states, Puerto Rico, Guam, American Samoa, and the Virgin Islands. I am pleased to have the opportunity to testify before you today on the Public Utility Holding Company Act of 1935.

APPA is concerned that the adoption of H.R. 5220, which deals with exempt electric utility holding companies, or the repeal of the 1935 Act proposed by H.R. 5465 and H.R. 6134 would have serious adverse consequences for electric consumers in general and municipal electric systems in particular. More than 900 local public power systems throughout the country purchase some or all of their power from investor owned utilities. Removal of the regulatory constraints imposed by Congress on electric utility holding companies in order to protect the interests of investors, consumers and the public alike, could significantly increase the

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cost of wholesale power for these public power systems. Moreover, the Act is an important anti-conglomerate, anti-takeover statute which has been effectively used by public power systems to prevent the concentration of control of the bulk power market in the hands of the few largest utility systems.

As evidence of our concern over amendments to this Act, I have attached to my testimony a resolution adopted by the membership of the Association at its annual conference in San Francisco in 1981 (Exhibit A). While the resolution specifically addresses amendments to the Act being advocated by the registered holding companies, the "resolved" clause is much more expansive. Our members have directed APPA to oppose any amendments to the Act unless they can be demonstrated to benefit consumers of the public utility holding companies.

In our invitation to testify, we were asked to comment on four specific questions. The issues raised in each of these questions are discussed in some detail throughout the statement. However, I would like to provide at this point answers to each of these questions before proceeding to analyze the various arguments advanced to support amendment or repeal of the Act.

Specific Questions

1. What is APPA's position on H.R. 5220, H.R. 5465, and H.R. 6134?

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APPA strongly opposes these bills. As explained in greater detail elsewhere in the statement, we believe H.R. 5220, by eliminating the ability of the Securities and Exchange Commission to withdraw an exemption when such action is clearly in the interests of investors, consumers or the public, is unwise. History has demonstrated that the holding company structure can be abused. It is essential to have in place a mechanism which can either prevent abusive practices before they occur or provide remedies to minimize damage from such practices after they are discovered. With respect to the other two bills, we believe the suggested "Congressional Findings" cannot be substantiated. Further, we believe repeal of the Act is clearly not in the best interests of either public power systems or the general public.

2. What are APPA's views on the benefits of implementation of the Act, and are not the benefits outweighed by the costs?

APPA believes that the benefits of retaining the Act far outweigh whatever costs are incurred by those utilities subject to the Act.

At the outset, we would suggest that this question seems to suggest that the Act can be evaluated on a cost/benefit basis. We do not believe this is a particularly fruitful exercise. Some of the costs and some of the benefits can be quantified. Others cannot. In today's context, the Act provides both active and

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passive restraints on utility operations. Both are designed to ensure that the "evils" identified by Congress in 1935 do not recur. From our own perspective as members of the utility industry, the Act provides protections which are unavailable elsewhere. The Act restrains diversification. Utility diversification involves risks for consumers. As major and captive consumers of wholesale power, many public power systems need and are entitled to the protections provided only by the Act. The Act also provides public power systems some protection from acquisition by larger and economically more powerful investor owned utilities. It also presents public power systems with opportunities to gain access to wholesale power on fair, reasonable and nondiscriminatory terms. Thus, the Act preserves and promotes competition in the electric utility industry.

Registered Holding Companies

Both costs and benefits must be evaluated based on the corporate structure of affected utility systems. The costs are greatest for registered electric utility holding companies. These costs fall within one of three categories: (1) compliance costs; (2) "lost opportunity" costs; and (3) subsidiary transaction costs.

Filing or Compliance Cost

Registered holding companies have estimated their filing costs to be approxmiately $500,000 per year. Accepting without question this estimate, the nine registered holding companies

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spend approximately $4.5 million per year. These same nine companies represent nearly 20 percent of the electric utility industry, had combined assess in 1980 of over $48 billion and operating revenues in the same year of nearly $17 billion. While $4.5 million is not an insignificant amount of money, it is a minor fraction of one percent of the total assets or operating revenues of these companies. Elimination of this expense through the repeal of the Act would have an insignificant budgetary impact, so insignificant it would not be felt by even the largest customers.

"Lost Opportunity" Costs

The registered companies have suggested that, because of the Act, they have not been able to take advantage of opportunities available to other industries, specifically, diversification into enterprises which are not functionally related to electric utility service. While there may have been lost opportunities which would have been profitable, undoubtedly, there have also been lost opportunities which, if pursued, would have been disastrous. This argument, on final analysis, is little more than an exercise of "Monday morning quarterbacking".

Lost Revenues on Subsidiary Transactions

Transactions between utility and nonutility subsidiaries of a registered holding company system must be based on cost plus a reasonable return. Because the utility is controlled by the holding company parent, and since the utility customers have no

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alternative for utility service, transactions between subsidiaries could obviously be more profitable if they were not restricted to a cost of service basis. However, Congress appropriately recognized in 1935 that subsidiaries within the same corporation could not be expected to deal at arm's length. One of the holding company evils identified in the Act was the loading of excessive charges for services, construction work, equipment and materials by a subsidiary on the utility. Thus, the prohibition regarding cost based transactions was found to be appropriate to protect utility consumers.

In addition, where subsidiary companies sell goods or services to independent third parties, profits must be credited to reduce the cost of transactions between the subsidiary and the affiliated utility. Here again, some revenues may be lost. But while the stockholders do not benefit from the profits of such transactions, the consumers of the utility do. As a general rule, this is entirely appropriate, since the subsidiaries exist to promote the utility operation. (It is important to note in this context that the Securities and Exchange Commission has the authority to allow the companies to retain the profits rather than crediting them to the benefit of the utility where special or unusual circumstances exist.)

Exempt Holding Companies

Exempt holding companies incur no major costs attributable to the Act. Exemptions may be obtained by filing a claim setting

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forth the justification for the exemption. When filed in good faith, nothing more need be done. If the exemption is subsequently challenged by the Securities and Exchange Commission, the exempt company may request an order, and, while that request is being considered, the status quo is maintained.

Exempt companies claim that they suffer what might be called "chill factor" costs. These are somewhat analogous to "lost opportunity" costs. Exempt companies feel that the Act has a chilling effect on diversification efforts, which arises because the Securities and Exchange Commission may, when appropriate to protect the interests of investors, consumers and the public, seek to withdraw an exemption previously granted, forcing the company to register and then divest its nonutility holdings.

The Act may have such a chilling effect. This is more appropriately categorized as a benefit, not a cost. As discussed in some detail later in this statement, diversification may have adverse consequences. It is appropriate that utilities approach diversification with caution and that some regulatory body retains the authority to protect captive utility customers should the diversification threaten continued reliable utility service.

Utilities Not Organized in the Holding Company Structure

Utilities not organized in the holding company structure incur no tangible costs as a result of the Act. The Act obviously serves as a restraint against the formation of new holding

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companies, particularly for those companies which could not qualify for exemptions under the Act. But utilities do not need to form holding companies in order to diversify. Some have diversified, quite successfully apparently, without resorting to this corporate structure.

Benefits of the Act

Some benefits have already been identified, such as inhibiting unrestrained diversification, protecting public power systems from takeover attempts, protecting public power systems and the public from concentration of control in the bulk power market, thus preserving competition. These benefits are all somewhat intangible. At the same time they reflect policies determined by Congress to be most consistent with the public interest.

Other benefits can be identified. For example, registered companies' financial structure is simple and straightforward. This promotes investor understanding and confidence and results in lower capital costs. Restricting transactions between subsidiary companies to costs benefits utility customers. The same is true when profits from transactions between subsidiaries and independent third parties are used to hold down utility costs. Finally, as is pointed out in the attached 1972 report of the National Association of Regulatory Utility Commissioners, diversification poses risks for utility customers without providing counterbalancing benefits. The Act provides an

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important degree of protection against the possible adverse consequences of unrestrained diversification.

3. What would be the effect of repeal or amendment on the public interest, including the interest of utility consumers in the provision of energy services at least cost?

APPA believes that the public interest would be adversely affected by repeal of the Act. Further, the public interest would not be served by amending the Act as proposed in H.R. 5220.

The public interest is best served by the preservation of competition in the electric utility industry. Repeal of the Act would promote monopoly control at the expense of competition. Public power systems have successfully used the Act to prevent concentration of control of the bulk power market in the hands of a few large electric utility systems. The Act provides a forum for a review of the acquisition of public utility assets, presenting at least an opportunity for public power systems which are the object of takeover attempts to challenge the takeover effort. On a larger scale, the Act protects major investor owned utilities from hostile takeovers by other utilities or by nonutility interests. For example, major oil companies would not, so long as the Act remains on the books, attempt to acquire electric utilities. Remove the Act and even the largest investor owned utilities could be subject to the corporate merger-mania

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which seems to be running wild in our society.

As far as we can determine, the Act does not prohibit or even inhibit utilities from pursuing a least cost energy strategy. The Act is sufficiently flexible to permit utilities to engage in activities designed to provide their consumers with energy services, whether those services involve conservation, load management, cogeneration, development of renewable resources or construction of central station generation facilities.

Our concern is that repeal of the Act may result in diversification activities totally unrelated to providing energy services. Managerial attention might thus be diverted from providing an essential commodity -- electricity or, more broadly, energy services -- to other areas. This is stated not as an attack on current utility management practices. It is simply a recognition that diversification is a procedure designed primarily to increase profits for the benefit of stockholders. The overly aggressive pursuit of this goal could occur at the expense of the utility and its captive customers.

4. Is utility diversification into functionally and nonfunctionally related businesses appropriate?

The problems of diversification are discussed in considerable detail later in this statement. APPA believes that diversification into functionally related enterprises is not only

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appropriate but essential to the survival of the electric utility industry. The Association has been encouraging its members to explore means of providing energy services to its consumer owners.

Diversification into nonfunctionally related businesses, particularly for the multi-state registered holding companies, poses risks for consumers and problems for regulators. We believe the Act appropriately recognizes these risks and problems, actively restricting registered holding company diversification and passively controlling the extent of exempt company diversification into nonfunctionally related enterprises.

The Act Should Not Be Amended Or Repealed

Those who advocate amendment or repeal of the Act advance two major arguments. First, they suggest that the Act has accomplished its primary purpose. The massive holding company empires, whose financial abuses and anti-competitive practices led to its passage in 1935, have been dismembered. Other regulatory bodies at the state and Federal level, and other provisions of law such as the Securities Acts of 1933 and 1934, have, they say, eliminated the necessity for further regulation pursuant to the provisions of the 1935 Act. In short, they say the Act is redundant, imposes additional regulatory burdens which are costly and unncessary, and repeal is warranted.

Second, they argue that the Act is an impediment to utility diversification into other business ventures. The opportunity to

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engage in diversification programs, unrestrained by the Act and the SEC, is regarded as a solution for the financial problems confronting the utility industry. Presumably, through diversification will come better management, stronger financial health and, ultimately, lower costs for utility consumers. We do not believe that these arguments are supported by the facts.

The Act Is Not Redundant

In evaluating the argument that the Act is redundant, it is necessary first to bear in mind precisely which utility holding companies are subject to SEC regulation. It was not the purpose of Congress to displace state with Federal regulation where state regulation could be presumed to be adequate. Such presumptions were made by the Congress on the basis of geographic factors, and utilities meeting these geographic conditions are entitled to exemptions (unless they operate in a fashion detrimental to the public interest or the interest of investors and consumers). (Sec. 3(a)) Only in those cases where, due to the multi-state nature of the registered holding companies, single state regulation was clearly inadequate, were the regulatory provisions of the Act to be applied.

When the Act was passed, nearly 85 percent of the electric utility industry was subject to reorganization and divestiture. Today, only nine registered electric utility holding companies remain. While few in number, these companies hold sixty electric utility systems. (They also control 38 non-utility but

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functionally related enterprises.) These sixty companies, in turn, represent approximately 20 percent of the nation's utility industry, with assets in 1980 in excess of $48 billion, and operating revenues approaching $17 billion. Their size, and more significantly, their multi-state character, demands regulation in an effective and coordinated manner. While the individual states can and do regulate the rates of these systems, to suggest that the individual state commissions can or will regulate these multi-state companies in a fashion consistent with maintaining the financial simplicity of the overall holding company is a difficult argument to accept. Even if one does accept this argument, it seems to make little sense to force several commissions to do what is now being done effectively by one.

Investor owned utilities would have us believe that the functions of the SEC under the Holding Company Act can be adequately performed by state regulators. In this area, considerable weight must be given to views of the state regulators themselves. Regulated holding companies have an obvious self-interest in suggesting that they are over-regulated and urging that these "regulatory burdens" be reduced or eliminated. We believe the state commissions are in a much better position to evaluate their own capabilities and determine whether the Federal role under the Holding Company Act continues to be appropriate and in the public interest.

In 1971, the National Association of Regulatory Utility

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Commissioners (NARUC) established an ad hoc committee on non-utility investments chaired by Joseph Swidler, former chairman of the Federal Power Commission and, at that time, chairman of the New York Public Service Commission. The ad hoc committee delivered its report at NARUC's Eighty-Fourth Annual Convention in 1972. (Portions of the report are attached as Exhibit B.) After an exhaustive study of diversification and regulation of utilities, the ad hoc committee concluded that "there is a need to strengthen controls over public utility diversification at both the state and Federal levels." (Emphasis added) In its conclusions and recommendations, the ad hoc committee stated that "in situations where state commission control is impractical, diversification by gas, electric, telephone and water utilities should be controlled by appropriate Federal agencies. Specifically: Electric power companies and local gas distribution companies should continue to be subject to the Public Utility Holding Company Act where they are components of public utility holding company systems."

Conditions change, and pronouncements in 1972 may not be valid in 1982. Recognizing this, the Swidler committee recommended that NARUC reexamine the issues of regulation and diversification in the future. As you undoubtedly know, such a review is now underway under the direction of Stanley York, Chairman, Wisconsin Public Service Commission. The final report of this ad hoc committee will not be available until July, 1982. It appears at this point, however, that the York committee will

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agree with the conclusions of the 1972 committee concerning the inadequacy of state regulatory control over multi-state holding companies and the necessity for continued Federal regulation under the 1935 Act.

An indication of NARUC's views on this issue are contained in a resolution recently adopted by the NARUC Executive Committee. That resolution states in part that "many state public utility regulatory commissions rely on provisions of the Act to assist in the effective regulation of electric and gas utilities within their jurisdictions." Further, "the contemplated changes in the Act may seriously jeopardize the ability of state commissions to regulate these utilities." (Emphasis added.)

In view of the SEC position calling for repeal of the 1935 Act, the NARUC Executive Committee felt it appropriate to adopt this resolution prior to completion of the ad hoc committee report. The resolution itself concludes with the recommendation that the SEC "reconsider its position." In a letter transmitting this resolution to SEC Chairman John S. R. Shad, Chairman York stated that the NARUC ad hoc committee "will take a firm position on the need for the Act." (Emphasis added.) (The York letter and accompanying NARUC resolution is attached as Exhibit C.)

Regulation of Affiliate Transactions.

Regulation of affiliate transactions highlights the unique and extremely important role played by the SEC under the 1935 Act

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in protecting utility consumers, forcefully demonstrating why the Act is necessary. (Regulation of these transactions is, we believe, one of the primary reasons why the registered companies would like the Act repealed or modified.)

Under the Act, transactions between affiliates within a registered holding company system generally must be based on actual cost of service plus a reasonable return. (The SEC does have discretionary authority to modify this where appropriate. They recently exercised this authority in a case involving the New England Electric System.) In view of the multi-state nature of the registered holding companies, and the resultant inability of state commissions to control transactions between affiliates, we believe the Act is not only appropriate, but absolutely necessary to protect utility ratepayers. Loading of charges by service companies on the utility was, after all, one of the abuses giving rise to the 1935 Act.

Proponents of repeal suggest that is is inequitable to subject only a portion of the electric utility industry to such controls, and further that such transactions are effectively regulated by other commissions -- state and Federal. Again, we would point out that the regulated holding companies represent approximately 20 precent of the utility industry, control sixty electric companies and 38 functionally related businesses, all of which operate in interstate commerce.

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For interstate companies, state commissions may have the ability to determine how and to what extent affiliate transactions will be regulated. It is difficult, however, for state commissions to control interstate transactions. (Even if they can at present, or could in the future through passage of additional legislation, exert sufficient control over these multi-state companies in order to protect the public and consumers, why should they be forced to do so when effective controls exist at the Federal level?)

Contrary to the claims of the investor owned utilities, not all affiliate transactions are regulated effectively by state commissions or by the Federal Energy Regulatory Commission. In February, 1982, FERC issued a staff report entitled "Automatic Adjustment Clauses in Public Utility Rate Schedules." This report included a review of transactions between utilities and their affiliate coal companies. (A copy of relevant portions of the FERC report, which included a summary of a 1980 FERC report on state regulatory oversight of electric utility associate fuel companies, is attached as Exhibit D.)

The FERC report concluded that "many of the state PUC's have limited resources with which to regulate affiliate coal operation effectively." The dangers to the consumer of inadequate regulation of these transactions are obvious. The FERC study noted, for example, that "transactions between a utility and its affiliate fuel company do not usually result from a process of

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arms-length bargaining by independent parties...(so) the possibility exists that affiliate profits may exceed reasonable levels or that subsidiary operations may be technically inefficient and consequently, utilities will be burdened with excessively high fuel prices." A survey of 36 state commissions revealed that "in some states, commissions appear to lack the authority to deal with affiliates. Many PUC's also lack the resources necessary to undertake the additional responsibilities of thorough investigations. Inadequate reporting and recording requirements and the resulting lack of systematic information contribute to regulatory problems."

In addition to state commissions, the FERC has some jurisdiction over prices paid for captive coal. However, FERC regulations require that it defer to other regulatory bodies where fuel is purchased from a captive mine and the price is subject to the jurisdiction of another regulatory body. The 1982 FERC report, however, indicated that "deferral to another regulatory body...may not provide adequate assurance of reasonable rates and may not alert the Commission to situations involving unreasonable rates." (Emphasis added.)

The SEC does have jurisdiction over captive coal prices in cases involving registered holding companies. True, this involvement is limited. As noted in the 1982 FERC report, "only 13 utilities of the 39 utilities involved in captive coal in 1978 are members of holding companies." These 13 companies, however,

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"used almost 50 percent of all the captive coal produced in 1978."

The FERC report clearly reveals that there are holes in the regulation of prices for coal from captive mines. (We believe we are justified in assuming from this that there are likewise holes in regulating other transactions between affiliates.) The solution to this problem, which may cause utilities and their customers to be "burdened with excessively high fuel prices" is certainly not to repeal a statute designed to prevent such high prices. Rather, means should be devised to ensure that consumers receive the protections to which they are entitled.

Registered holding companies also object to the requirement that affiliate profits earned on transactions with independent third parties must be applied to reduce charges for services rendered to the utility. This is clearly appropriate in view of the purposes of the Act and the abusive practices it was designed to eliminate. If these profits were not balanced against costs, cost of utility service would increase. In addition, and more important from a regulatory standpoint, problems of appropriate cost allocation and transfer pricing would arise.

The "Regulatory Burden" Argument

Proponents of repeal further suggest the consumers will benefit from removing the cost of an additional layer of regulation by the Securities and Exchange Commission. These costs are insignificant and are more than offset by the benefits

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afforded by SEC regulation. Registered companies have stated that compliance costs amount to $1/2 million or more per year. For a small business, these costs might be a real burden. However, the registered holding companies are not small businesses. In 1980, American Electric Power Company had assets of $10.9 billion and operating revenues of approximately $3.7 billion; Middle South had assets of $7.3 billion and operating revenues of $2.3 billion; and The Southern Company had assets of $11.4 billion and operating revenues of $3.7 billion.

At the same time the registered companies are complaining about compliance costs, they are also saying that the information required to be filed under the Holding Company Act are largely duplicated by filings required by the SEC under the Federal securities laws. If this "duplicate filing" argument is valid, then the financial burdens on the registered companies will not be significantly reduced by eliminating this one statute.

Duplicate regulation under the 1935 Act and the Federal securities laws is another argument advanced as justification for repeal of the Holding Company Act. While reporting requirements may be similar, it is incorrect to suggest that that be Federal securities laws obviate the necessity for the Holding Company Act. This fact is evident in the December 1981 letter of SEC Chairman Shad to the Chairman of this Subcommittee. In that letter Chairman Shad stated "moreover, certain features of the 1935 act set it apart from the other statutes which the Commission

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administers. The Federal securities laws focus primarily on disclosures to investors and on the integrity of the securities markets. In contrast, acquisitions, financings and other actions by registered public utility holding company systems require prior commission approval under the 1935 Act. The commission must base its approval or disapproval of these transactions on its determination of their economic merits." (Emphasis added.)

Against the burdens imposed by the Act, this Committee must weigh the benefits which have accrued to investors, consumers, and the general public. In contrast to the complicated financial structure of the holding company systems in the '30's, today's holding company systems operate in a straight-foward and uncomplicated manner. We believe that the uniform, simple, capital structure of the existing holding companies have promoted investor confidence and have helped to hold down the cost of capital. Because of their straightforward and simple capital structure these systems have a higher investment quality and therefore lower cost of capital. We are not persuaded by the argument that because the systems have a simple capital structure today, they will continue to have such a capital structure tomorrow should the Act be repealed. It is not beyond the realm of possibility that the abuses which gave rise to the Act could recur in its absence.

Municipal Utility Interest

In the recent past, public power systems or their customers

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have intervened or instituted proceedings at the SEC to protect their access to wholesale power, prevent concentration of control in the wholesale power market, or attempt to preserve their public power systems. The Act has presented opportunities to these systems and their customers which are not available elsewhere. Some examples will illustrate how the Act has been used and demonstrate at the same time that it sill preforms very important functions.

A few years ago, the American Electric Power Company petitioned the SEC to approve the acquisition of the Columbus and Southern Ohio Electric Company. The SEC recognized that the position of the wholesale purchasing municipal electric utilities in Ohio would become more precarious following the acquisition due to the increased concentration of control in the electric bulk-power market. Consequently, the SEC's approval of the acquisition was conditioned on a requirement that AEP would either build or sell generating capacity to the municipal systems. The condition was considered to be so material to the SEC approval that it delayed entry of an order granting AEP's application until it was provided with further assurance that the settlement was capable of being executed and the municipal electric systems protected.

In another case, several investor owned utilities in New England requested SEC approval of stock acquisition in two nuclear generating companies which they were organizing. This acquisition

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was opposed by several Massachusetts municipal electric systems which contended the SEC should require the companies to permit participation by municipal electric systems on the same terms provided for the sponsor companies. The municipals argued that without such an opportunity, the venture violited anti-trust laws.

The SEC initially refused to consider this argument. On appeal, the U.S. Court of Appeals for the District of Columbia agreed with the municipalities. The Court held that the SEC could not determine that the acquisition was in the public interest without examining the effect on competition of concentrating supply of low cost bulk power in the hands of the investor owned utilities. The case was subsequently resolved when the investor owned systems were required under the authority of the Holding Company Act to permit municipal systems to buy into new generating companies.

Concentration of control, whether through monopolies in the bulk power area or increasing the monopoly control throught the acquisition of retail distribution systems, particularly the small and most vulnerable public power and rural electric cooperative systems, continues to be a problem. The Act was clearly designed to prevent such concentation. As noted, the Act provides opportunities for review of proposed acquisitions of utility property by the SEC. This aspect of the Act allows public power systems or their consumers to challenge takeovers of such systems. This is particularly true where the acquiring utility is a

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registered holding company or one of its subsidiaries.

For example, the SEC currently has before it a request to investigate the acquistion of Monroe, Louisiana's electric utility systems by Louisiana Power and Light, a subsidiary of the registered holding company Middle South Utilities, Inc. This situation, as well as a discussion of the importance of the Act to prevent monopolistic practices, is discussed in Exhibit E.

Utility Diversification

Diversification into non-utility businesses to improve the financial condition of the nation's electric utilities is the most frequently advanced argument for repeal or major modification of the 1935 Act. The New York law firm of Reid and Priest, on behalf of a large number of exempt electric utility holding companies, suggested in a memo dated September 21, 1981, that allowing public utilities to diversify into other "more profitable business fields" represents a "simple near term measure that ameliorates the problem" of the unhealthy financial condition of the electric utility industry.

Diversification is by no means a simple solution. Don C. Frisbee, Chairman and Chief Executive Officer of Pacific Power and Light, one of the most widely diversified electric utilities which derives 46 percent of its operating income from non-electric businesses, recently conceded "you can make more mistakes in new business." He stated further "I am not an advocate of

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diversification for utility companies. Generally speaking it is a path that has more dangers than opportunities because of the difficulties of trying to mix a typical management approach to the highly regulated utility business with the entrepreneurial approach needed in unregulated arenas." (Emphasis added.) (See Business Week , January 18, 1982 "Pacific Power and Light: Still Diversifying as Electric Use Slows" page 58). (In the same article Stanley T. Skinner, Executive Vice President of Pacific Gas and Electric Company states "I think diversification is something of a cop-out.")

Those who advocate utility diversification as a solution to the poor financial health of the investor owned utility industry present several arguments. These arguments were all addressed and, for the most part dismissed, by the 1972 NARUC ad hoc committee on non-utility investment. (See Exhibit B)

The arguments supporting diversification, and the rebuttals contained in the NARUC report, may be summarized as follows:

1. The freedom to diversify into more profitable business will improve the overall financial condition of the holding company, reduce captial costs and benefit utility customers. The NARUC ad hoc committee found this argument "not persuasive." Earnings from non-utility sources are considered riskier than those from utility sources. Thus diversification may in fact increase the

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cost of capital. Further the argument is based on the questionable assumption that the new venture will be profitable. If the venture is unprofitable, however, then it may harm the overall financial condition of the holding company, increase capital cost, and hurt the utility customers.

2. Diversification of risk will enhance access to capital which will in turn facilitate public utility financing. The NARUC Committee concluded that in some cases this argument may have merit, but it is generally not true for large electric power companies. In any event, diversification of risk is a policy designed to protect investors, not utility customers. Thus, with respect to diversification of risks, the NARUC committee report states as follows: "If a public utility engages in substantial diversification and is successful, the principal beneficiary is the stockholder and not the utility consumer. If diversification proves to be unsuccessful, the stockholder is injured and the risk is great that the utility customer will be injured as well. The stockholders of a utility may win or lose as a result of diversification but the consumer bears the risk of failure without any commensurate particpation in the benefits of success."

3. Diversification is necessary to attract and retain highly

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competent management. An equally valid counter argument is that diversification dilutes managerial attention and, to the extent management is concerned with non-utility operationss the utility operations may suffer. These arguments, according to the NARUC report, cancel one another out.

We believe that the problem of diversion of managerial attention to non-utility operations could have extremely serious consequences. In a speech before the New York Society of Security Analysts on February 17, 1982, the Edison Electric Institute President William McCollam, Jr. stated that investor owned utilities project a five year construction program which will cost a total of $165 billion. Investments of this magnitude demand that utility management attention not be diverted to other areas.

It is equally important that capital not be diverted from utility to non-utility investment. The problems of accurate load forecasting are by now common knowledge. A relatively small change in load growth compounded each year during the several years required to bring a new plant on line can have an incredible impact on a utility's ability to meet its demand. It is conceiveable that management might be less than objective in evaluating load growth forecasts, selecting lower growth projections in order to have more capital to invest in diversified ventures. If capital is so diverted, new capacity might not be available when needed.

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The 1972 NARUC report was not completely negative with respect to diversification. It did suggest that diversification into functionally related activities where there were joint products, by-products and complimentary services might well be appropriate.

But even in this area, diversification should not be unrestrained. First, the activity should clearly be functionally related to utility service. For example, utilities might diversify into the fuel supply area, and as a corollary acquire means of transporting the fuel from the source to the generating station.

Second, the NARUC committee report suggested that the functionally related activities should not approach the size of utility operations. Third, the NARUC committee concluded that the activity must not violate anit-trust standards.

Experience over the past 10 years, however, has indicated that diversification into functionally related areas, for example supply, have not always operated to the benefit of the utility. The FERC study on automatic adjustment clauses (Exhibit D) addresses the issue of utility captive coal mining operations. The report indicates that "(1) captive coal prices are on average significantly higher than comparable non-captive coal prices; (2) captive coal mines appear to be operating less efficiently than

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comparable non-captive coal mines; and (3) regulation of electric utility affiliated coal operations may be inadequate to assure the efficient management of captive mines and the reasonableness of the captive coal prices."

Diversification does pose risks. That fact can't be disputed. The more than 900 public power systems who purchase power at wholesale are, like other utility customers, captives of the supplying utility. They are entitled to adequate regulatory protection from the potential adverse consequences of diversification. It is possible that wholesale power bills could increase in any number of ways: failure of the diversified venture; improper allocation of common utility and non-utility costs; inapproprate transfer pricing; spin-off of a utility system should management conclude that diversified ventures are far more profitable. We strongly believe that the Holding Company Act either actfvely as it applies to registered companies or as restraint in the case of exempt companies provides us with such regulatory protection.

Specific Legislative Proposals

At this point I would like to turn to the specific measures pending before this Subcommittee.

H.R.5465

Quite obviously APPA disagrees with both the Congressional findings and the proposed repeal of the Holding Company Act

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contained in H.R.5465. Without restating all the arguments advanced above, we would offer the following comments on the recommended Congressional findings in H.R.5465:

1. We agree that the Act does subject utility holding companies to a level of regulation not found necessary for other organizations in the same or related industies. Because utility service is a twentieth century necessity, however, we believe that such regulation is not only appropriate but essential.

2. We agree that the holding company empires which gave rise to the passage of the Act have been dismantled. We also agree that the capital structures of the few remaining registered holding companies have been simplified. We are not convinced, however, that the abuses prevalent in the late '20's and '30's would not recur should the Act be repealed. Further, we do not believe that the multi-state holding companies can be effectively regulated without the 1935 Act.

3. While only a small number of holding companies are regulated under the Act, these companies represent nearly 20 percent of the electric utility industry and consist of 60 operating electric utility systems. Because of their multi-state nature it is appropriate that they be regulated as single entities. State regulation is inadaquate to accomplish this purpose. Control over the

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these multi-state organizations can only be exercised by the Federal government.

4. We do not agree that the Securties Act of 1933 and Securties Exchange Act of 1934 are adequate substitutes for the protections afforded investors, consumers and the public by the Holding Company Act of 1935. Nor do we believe that state regulatory commissions have, for the most part, either the authority or the ability to review acquisitions and transactions entered into by public utility operating companies and their affiliates, particularly when these companies are multi-state in nature.

5. We do not believe that the Holding Company Act inhibits innovation. It does appropriately inhibit unrestrained diversification. These restrictions are entirely appropriate. Diversification presents risks for utility consumers. They stand to gain little and lose a great deal should diversifcation prove unsuccessful. If, however, the Congress should conclude that diversification is appropriate, modest changes in the Holding Company Act can be adopted to premit this to occur while at the same time protecting the interest of investors, consumers and the public.

H.R.6134

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Like H.R.5465, H.R.6134 calls for repeal of the Act. Many of our comments on the proposed Congressional findings provisions of H.R. 5465 are relevant to the comparable provisions of H.R.6134. Two additional comments are appropriate.

1. We disagree with the suggestion that there are no regulatory benefits flowing from the implementation of the act. The benefits, both tangible and intangible, have been discussed at the beginning of this statement.
2. It is suggested that Congress, through its oversight authority, can determine whether the interests of investors and consumers are being adequately protected, and can act to protect such interests if necessary. The Act already protects these interests. We see no reason to place in jeopardy the interests of investors, consumers and the public by repealing the Act. Nor do we believe Congress can act with sufficient speed to protect such interests should the evils identified in 1935 recur.

H.R.5220

H.R.5220 is applicable only to exempt holding companies and would (1) eliminate the authority of the SEC to withdraw an exemption once granted, and (2) provide two new catagories for exemptions.

Under section 3 of the 1935 Act, the Commission may exempt utility holding companies if they meet certain qualifications.

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These exemptions remain in effect "unless and except insofar as it (the Commission) finds the exemption is detrimental to the public interest or the interest of investors or consumers." APPA can see no conceivable justification for removing this authority.

Exempt companies argue that the "unless and except" provision has a chilling effect on their diversification plans. Fear of loss of the exemption has caused them to take a cautious approach to diversification. We will accept this argument, but hasten to point out that unrestrained diversification might result in financial disaster rather than financial salvation. (Certainly the Penn Central disaster of the early '70's is ample proof of this fact).

Exempt holding companies can and do diversify into areas which are not functionally related. They believe, however, that at some point the Commission may arbitrarily and capriciously withdraw the exemption, subjecting them to the full requirements of the Act, including divestiture.

We do not believe arbitrary and capricious actions would be tolerated, by the Commission, the courts or Congress. The "unless and except" clause can only be utilized when it is found that the exemption is "detrimental to the public interest or the interests of investor or consumers". Legislative history as well as provisions of the Act, specifically provisions contained in section 1(b), provide considerable guidance to the Commission in

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determining when actions may be found to be detrimental to the interest of investors, consumers and the public.

This "arbitrary withdrawal" argument was made during debate over provisions of the Pacific Northwest Electric Power Planning and Conservation Act during the 96th Congress. In that case, investor owned systems in the Pacific Northwest desired an exemption from the 1935 Act in order to establish regional generating companies within a holding company structure. The Congress refused to grant a blanket exemption. Instead, it provided a conditional exemption subject to withdrawal by the SEC should the generating companies fail to abide by the policies of the Holding Company Act. The investor owned utilities objected, arguing that the policies were vague and arbitrary withdrawal a realistic possibility.

The House Committee on Interstate and Foreign Commerce disagreed, pointing in particular to section 1(b). The Committee report, (Rept. 96-976. part 1) noted that the "the term 'policies' of the 1935 Act is not defined by the Committee. The agencies (Bonneville and the SEC) are, obviously, given some leeway to define them in light of the Act and its application today and in the future. The bill places a duty on both agencies. The Committee expects that it will be exercised properly and fairly, but with effect." (Report, p.73, emphasis added.)

We believe the Congress was then, and is today, fully

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justified in placing its trust in the discretion of one of its own creation. Should that trust be abused, the Congress can react appropriately.

In addition, the Commission has addressed itself to the question of exemption withdrawal in Pacific Lighting Corporation, 49 SEC 152 (1973). This decision provides guidance to exempt companies who desire to diversify.

If the diversification venture is successful, we can't believe the SEC would suggest the exemption should be withdrawn. The very fact that the exempt companies fear withdrawal of their exemption is, in effect, an admission against interest. They are saying that diversification may not be successful, may adversely affect the interests of their investors and consumers. Yet notwithstanding this, they feel they should continue to remain exempt. By requesting the repeal of the "unless and except" clause these exempt companies are requesting flexibility to diversify without restraint. Yet they would deny comparable flexibility for the SEC to react to changed circumstances detrimental to the interest of investors, consumers or the public.

We do not believe the standards for exemption are vague. If the Congress believes otherwise, the Commission could be directed to institute rulemaking proceedings, under the guidance of specific statutory provisions, which will further clarify the matter.

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Conclusion

In conclusion, APPA is convinced that the 1935 Act continues to serve a very beneficial purpose. It has protected the interests of investors, consumers and the public for nearly fifty years. It has prevented the concentration of control in the electric bulk power market. Public power systems have benefited from this anti-conglomerate feature of the Act. It assists the state commissions in the exercise of their regulatory responsibilities. It properly restricts, actively or passively, utility diversification.

The Congress, of course, may disagree, finding some merit in the arguments advanced in favor of diversification. Since only registered companies are actually precluded from diversification into non-functionally related businesses, minor modifications in the Act might be found appropriate. The solution, however, is certainly not repeal, or even drastic modification. Amendments should be fashioned which will permit diversification within limits and subject to SEC oversight. While we believe it unnecessary, the Congress might also wish to direct the SEC to undertake a rulemaking to define appropriate limits for diversification by the exempt companies.

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EXHIBIT A

PUBLIC UTILITY HOLDING COMPANY ACT

WHEREAS, a number of registered public utility holding companies have joined together in an effort to devise various amendments to the Public Utility Holding Company Act in the following respects:

1. Grant the Securities and Exchange Commission broad discretion to exempt from review the issuance of holding company securities or to repeal SEC's authority in this area entirely;

2. Permit holding companies to acquire nonutility businesses which are not functionally related to the utility business;

3. Reverse legislatively an administrative policy which requires service affiliates of holding companies to reduce their charges for services to operating subsidiaries of the holding company by any profits which they earn providing like services to entities outside of the holding company;

4. Eliminate the requirements that all service, sales or construction contracts performed by a subsidiary of a holding company or a mutual service company for any associate company must be performed at cost, permitting such services to be performed at fair market value; and

WHEREAS, these proposed amendments are not consistent with the public interest, specifically:

1. Broader authority to exempt from SEC review the issuance of holding company securities in unnecessary since SEC has ample latitude to prejudge security issues and insure that companies may enter the market at the most advantageous time. Elimination of the SEC review authority, however, would deprive consumers of one of the basic protections of the Act.

2. Allowing holding companies to enter into non-related business could result in serious financial harm to the holding company and seriously impair

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its ability to carry out its electric service to their consumers. Incidental benefits to the holding company flowing from the sale of services outside the holding company systems should accrue directly to the electric utility consumers through lower rates.

4. Allowing affiliate companies to charge the fair market value rather than requiring that such transactions be cost based is contrary to one of the basic purposes underlying the passage of the Act. Congress was concerned about abuses which had arisen from contracts between associated companies of the same holding company systems, and the cost standard was designed to compensate for the absence of arm's length bargaining, and

WHEREAS, the suggested amendments, if enacted, might encourage the creation of new electric utility holding companies;

NOW, THEREFORE, BE IT RESOLVED: that the American Public Power Association opposes any amendments to the Public Utility Holding Company Act except amendments, either previously identified or subsequently proposed, which clearly and demonstrably will operate to the benefit of the customers of the public utility holding companies.

Adopted by the membership of the American Public Power Association at the annual conference June 23, 1981, San Francisco, California.

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NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

1972

REPORT OF THE AD HOC COMMITTEE ON NON-UTILITY INVESTMENTS

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* Consists of Parts IV and V, pages 720-736.

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EXHIBIT B*

INTRODUCTION

After approval by the Executive Committee in March 1971, NARUC President George I. Bloom appointed the Ad Hoc Committee on Non-Utility Investments to examine the trend toward diversification among regulated companies and to determine the effect of such diversification on public utility regulation. A progress report was submitted to the National Association of Regulatory Utility Commissioners at the annual meeting in September 1971.

The committee has met frequently, in New York City, Chicago, and Atlantic City. The initial meetings were devoted to outlining a procedure for securing necessary data and information. The later meetings were devoted to analyzing the material received by the Committee, outlining a report, and reviewing and revising the several report drafts.

As a part of the study extensive questionnaires were directed to State Commissions, industry groups and others whose viewpoints seemed likely to be helpful. In addressing ourselves to the industry trade associations we invited comments from individual companies and a substantial number were received. Separate inquiries were made of the major diversified natural gas pipelines. Inquiries were directed to two bond rating agencies and to various financial institutions. The responses of the bond rating agencies are attached as appendices.

The Committee sought also to secure the benefits of the information and viewpoints of the Federal Communications Commission (FCC), Securities and Exchange Commission (SEC), Federal Power Commission (FPC), and Interstate Commerce Commission (ICC). The Federal agencies were invited to send representatives to the meetings of the Committee. Aaron Levy, The Associate Director in the Division of Corporate Regulation, SEC, William White, Chief of the Domestic Rates Division, Accounting Section, Common Carrier Bureau, FCC, and Kelly Griffith, Chief of the Domestic Rates Division, Common Carrier Bureau, FCC, attended one or more meetings. Mr. Levy supplied extensive data for the Committee's consideration and some data were also received from the ICC and FCC. The Committee wishes to

acknowledge its indebtedness to the individuals named and to the agencies for which they work for their participation and cooperation.

Harry Westcott, recently retired as Chairman of the North Carolina Public Service Commission, participated in the early stages of the preparation of the report and the Committee expresses its appreciation for his help.

The Committee acknowledges a special indebtedness to Everett L. Morris, former Director of Accounting and Tariff Analysis of the New York State Public Service Commission, who served as Secretary and who handled most of the staff burden, as well as contributing to the preparation of the report. The Committee also expresses its appreciation to Catherine D'Andrea, a member of the staff of the New York Public Service Commission, who performed much of the research work in compiling data on diversification. However, the Committee takes full responsibility for the report in form and substance.

The extensive files accumulated in the preparation of the report are available for examination at the offices of the New York State Public Service Commission in Albany.

This report is concerned solely with gas, electric, telephone and water utilities. Moreover, while the report discusses non-utility activities which are functionally related to utility operations, the main focus of the report is on functionally *unrelated* operations, and it is this type of "diversification" which is the principal subject of discussion.

The report considers:

The general phenomenon of diversification.

The nature of public utility financing.

The nature of the considered public utility industries, both generally and in particular.

The extent of diversification in the particular public utility industries.

An evaluation of the advantages and disadvantages of diversification by the considered public utilities.

The adequacy of existing regulatory controls over diversification by public utilities.

Finally, conclusions and recommendations are set forth.

The Committee, in studying this problem, also has reviewed the testimony in pending SEC proceedings concerned with problems of diversification, has reviewed testimony in Congressional hearings, and has considered the textual material and numerous articles dealing with the subject.

A final preliminary word. The Committee's perspective, naturally enough, has been that of the utility consumer and the regulation of utilities in the consumer's behalf. We have not attempted an appraisal of the problems of diversification from the perspective of management or investor, although we

have considered the arguments made by management and investor interests a. to the public benefits of diversification.

Respectfully submitted,

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August 11, 1972

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An analysis of available information on the results of the diversification of the pipeline industry does not disclose the extent of the profitability of the diversified activities of the pipelines. To arrive at valid conclusions is practically impossible without a detailed internal examination of each major company, since the pipelines do not freely disclose such information. Reporting requirements in effect during past years did not require sufficient breakdown by product or type of activity to enable investors and the general public to determine the profitability of different activities. The Federal Power Commission and the Securities and Exchange Commission may require more detailed reporting in the future. In addition, the accounting profession, in response to public pressures, is encouraging more informative reporting.

It does seem clear that pipelines have been able to enter diversified activities because of the financial base and support afforded by the basic pipeline activities. Higher revenues do not necessarily insure higher profits, but a pipeline operation generates a stable cash flow which can be used to even out the cyclical turns in non-utility businesses.

All diversified activities undertaken by pipelines have not been successful. For example, Bauer Dredging Company, owned by Texas Gas Transmission, had a loss of over $2 million in 1970. El Paso's textile division was chiefly responsible for El Paso's earnings decline in 1970. Colorado Interstate had profit declines in its petroleum division and in its Marsh Instrument Company in 1971.

There is little evidence to show that the customers of the natural gas pipeline companies have benefitted as a result of diversification activities of the pipelines with one possible exception. Southern Natural Gas, because of its highly successful Offshore Company, may have maintained credit equal or superior to what it could have maintained solely on its pipeline operations. To the extent that it has superior credit, if it does, the lower overall capital costs benefit its pipeline customers. A careful examination of Tenneco's operations, including the capital it has raised, the cost of its capital, and the profit contributed by its pipeline, tends to support the conclusion that its pipeline customers have not received any benefits as a result of Tenneco's diversification "successes".

To contribute to a balanced presentation on the difficult question of consumer benefit from diversifcation as it relates to pipelines, the entire responses of W. M. Elmer, Chairman of the Board of Texas Gas Transmission Corporation, and of Marvin Chandler, Chairman of the Executive Committee, Northern Illinois Gas Company, are attached as Appendix A and Appendix B, respectively. These are the most comprehensive and strongest arguments favoring utility diversification received by the Committee.

IV. EVALUATION OF DIVERSIFICATION BY PUBLIC UTILITIES

Evaluation of the wisdom of diversification by public utilities is a difficult and complex problem because: (a) diversification has many different aspects

(see Section II); (b) the problem of public utility financing poses serious problems (see Section III); and (c) each of the public utility industries differs in important characteristics, in the extent of existing diversification, and in limitations on that diversification (see Section IV). Nonetheless, the following generalizations appear to be appropriate:

A. Utility Credit

The maintenance of assured public utility financing is of such critical importance that every effort should be made to sever public utility operations from non-public utilityoperations, particularly where the latter are substantial in scope. The maintenance of public utility credit, through the protection of the investment-revenue cycle, has been the dominant consideration behind the regulation of public utility securities by state and federal agencies and is a basis for regulatory surveillance of transactions between public utilities and their affiliates. The alternatives to protecting the investment-revenue cycle are threats of impairment of the utility's credit or inflation of the utility's rates or both. The threats posed by extensive utility diversification are neither new nor illusory. Indiscriminate diversification by public utilities was one of the factors underlying passage of the Public Utility Holding Company Act of 1935. It also was one of the causes of the recent Penn Central debacle (as well as some of the earliest tribulations of the New Haven Railroad).

The current emphasis in regulatory circles is on taking preventive measures, rather than waiting for a crisis before taking action. Regulatory officials would be justly subject to criticism if, with the Penn Central example before us, appropriate measures were not taken to protect the critical function of public utility financing from possible impairment resulting from uncontrolled diversification.

B. Earnings Growth

One argument frequently made in favor of diversification by public utilities is that, because of regulation and other factors, the rate of growth of profits from utility operations is circumscribed. Greater profit growth can be achieved from non-utility operations, the argument goes, and such growth makes the enterprise more attractive to investors, thereby reducing the cost of capital to the benefit of utility customers.

The argument is not persuasive. Even in the case of successful diversification, the available evidence—including an FPC study and communications from the rating agencies (see Appendix C)—suggests that diversification *increases*, rather than decreases, the cost of capital to the enterprise. The reason, quite simply, is that earnings from non-utility sources (growth or no growth) are considered riskier than earnings from utility sources. Thus, much more of a non-utility's new money must be obtained from stock rather than debt, with corresponding impact upon return. Appendix E presents an

argument for adjusting a utility's equity to eliminate investments in non-utility activities. Appendix F contains some restraining comments on the proposal set forth in Appendix E. Although it is not appropriate to adopt a rigid rule on the treatment of non-utility investments, this is an important issue that must be dealt with if utility consumers are to be protected from excessive capital costs.

In any case, the whole argument proceeds from two critical assumptions: (1) that management will be able to select investments more promising than the utility operation in question, and (2) that management is capable of effectively operating the new businesses it acquires. While there are numerous examples of successful utility diversification, there are examples of failures as well.

Florida Gas Company lost several million dollars in modular housing and has millions more invested in the venture, the recovery of which appears doubtful.

Northern Illinois Gas Company lost $29 million gross on its fertilizer business.

Pacific Lighting lost substantial amounts in a central air conditioning plant venture, and has over $20 million unrecovered investment in this activity.

These examples are cited not to prove that diversification by utilities generally, or even by these particular utilities, has been unsuccessful. (We have indicated the contrary above.) However, the examples cited do indicate the risks involved, and there are several small utilities which appear to be supporting unsuccessful non-utility ventures with revenues from their utility operations in direct contravention of the premises underlying public utility financing. See Appendix D on the Elizabethtown Gas Company diversification.

The riskiness of diversification is further exemplified by non-utility experiences. In the case of conglomerates generally, there have been failures as well as successes. Diversification does not provide guaranteed returns, since success is dependent on both the skill of management and good or bad fortune attending various risky ventures.

In general, therefore, the public utility customer has everything to lose and little to gain by acceptance of this argument.

There is, however, a more limited argument that may have merit. In connection with the discussion of "diversification of risks" (page 40), it is pointed out that in the case of small utilities (independent telephone companies, water companies, small electric or gas companies) geographical diversification through specialized holding companies is a justifiable approach. By reducing risks, such diversification also should reduce the cost of capital. Furthermore, the accumulation of many small enterprises into specialized holding companies permits capital to be raised in larger quantities and at lower unit costs, and protects small operations from the adverse impact of temporary adversity. The severe impact of the June, 1972 floods

accompanying the tropical storm "Agnes" upon small independent utilities, such as the Corning (N.Y.) Gas Company, illustrates the point. In the event of extensive system damage a territorially diversified system is better able to repair the damage and resume normal service. In most instances, the availability of a telephone holding company or a water holding company or a gas or electric holding company should suffice for the purpose of achieving geographical diversification, capital attracting units of appropriate size, and some measure of "financial strength". There may be rare instances in which a small utility can attract capital on an appropriate basis only by affiliation with a diversified firm. Exceptions should be considered for such cases if they are shown to exist.

At several points reference is made to specialized holding companies, particularly in connection with the independent telephone and water industries. We make clear that while we think specialized holding companies may have a role as a preferred means of dealing with problems not otherwise soluble, we intend no adverse view on the continued operation of independent companies outside the holding company framework where it is practicable to conduct such an independent operation. We think also that where holding company systems combine utility and unrelated non-utility activities, the utility financing function is protected to some degree if the utility functions and unrelated non-utility functions are segregated in separate companies or separate subsystems of holding companies. The protection is not complete but it is helpful, and regulatory efficacy probably is promoted in other ways by such a separation, even though problems will remain (e.g., possible commingling of utility and non-utility funds through intercompany loans and guarantees). It should be noted that leading holding companies in both the independent telephone industry and the water industry–General Telephone and Electronics and International Utilities, respectively–are organized substantially along such lines.

C. Diversification of Risks

It might be argued that, by providing for diversification of risks, the entry by public utilities into unrelated fields will enhance their access to capital markets and facilitate public utility financing. In limited contexts, the argument has merit. But stated this broadly it confuses the basis of public utility financing with business financing generally. The nature of the problem can best be explored by distinguishing among several different situations.

First, for large electric power companies and for the Bell System, diversification of risks is unnecessary. Both operations are integral to the successful functioning of our society and economy and both will survive as vital entities as long as our society and economy survives in anything like its present form. As previously discussed, neither is threatened by changes in demand, costs, competition or technology–despite the difficulties that will be encountered by both.

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Second, for independent telephone companies, water companies, and small electric companies, there may be a need for protection against the risks associated with a particular locality. But this kind of protection can be achieved—along lines already exploited extensively—by the formation of holding companies encompassing telephone companies, or water companies, or electric companies, located in different parts of the country. Once protection is achieved against the uncertainties of social and economic activity in a particular region, and the risks of natural disasters, the situation becomes analogous to the first case. Considering trends in demand, costs, competition and technology—telephone, water and electric service will be required from the existing industry for the indefinite future. Once geographical diversification is achieved, no further diversification of risks appears to be necessary.

Third, the gas industry provides a wholly different situation. As previously indicated, the future of the gas industry is clouded by the limitations on conventional domestic gas reserves. Growth of the industry will be restricted, and a major shift in sources of supply will be required. Natural gas pipelines and local gas distributors are confronted with substantially larger risks than the other utilities under consideration. Does this provide a good case for diversification?

(a) The investor in a gas company may indeed benefit if the company diversifies. But the existence and extent of the benefit will depend on whether management is able to select investments more promising than the gas industry itself, and whether management is capable of effectively operating the new investments it acquires. Neither is a foregone conclusion, and indiscriminate diversification is not necessarily the best solution to an industry's problems. A number of unsuccessful diversification ventures are noted previously in this report.

(b) It is not clear that successful diversification, even if beneficial to the investor, will be helpful to the utility customer. The assumption appears to be that a successful diversified company, earning profits on non-utility operations, will pour those profits into an unprofitable utility operation. Stated this way, the whole idea is business and financial nonsense, and examples can be found in the history of the railroads, and more recently in the activities of Western Union, to support the proposition that businessmen are not anxious to support a losing operation whether or not they are making money on other operations. (Sufficient financial strength to weather limited or temporary reverses is a different matter, and is considered in other parts of this report.)

As the previous point makes apparent, the general thrust of "diversification of risks" is to protect the investor and not the utility customer. It is arguable that the major aim of public policy—regarding the customer as the principal beneficiary of regulation—should be to *prevent* "diversification of risks". Suppose the gas industry were informed: "You are not going to be permitted to diversify. Either you find a means of meeting your public service obligations or you will go bankrupt!" If the analysis in the previous point is valid, the customer ultimately is no worse off under bankruptcy than under the sustained neglect incident to a losing operation. Indeed, bankruptcy would more likely precipitate prompt public intervention if the service is considered to be socially necessary. At the same time, without the option to diversify, the motivation for the industry to succeed in meeting its public service obligations is strengthened. It is a good question whether the natural gas pipeline industry would be imposing curtailments of deliveries today if the pipelines had not been permitted to diversify, and if they had been aware at all times that their success depended on the delivery of gas and nothing else.

This is the heart of the matter. If a public utility engages in substantial diversification and is successful, the principal beneficiary is the stockholder and not the utility consumer. If diversification proves to be unsuccessful, the stockholder is injured and the risk is great that the utility customer will be injured as well. The stockholders of a utility may win or lose as the result of diversification, but the consumer bears the risks of failure without any commensurate participation in the benefits of success.

(c) Even in the special case of the gas industry, it is not clear that diversification of risks is in the public interest. However, this conclusion should not be read as precluding the combination of gas transmission and distribution companies with other entities engaged in supplying energy requirements in order more successfully to meet those requirements. Thus, the entry of gas transmission and distribution companies into areas of gas supply (LNG, SNG, exploration and development of new reserves) should be encouraged; this kind of activity is not prohibited by the Public Utility Holding Company Act. Moreover, the formation of "combination" gas and electric companies should not be prevented, nor should existing combination companies be required to separate the two functions.* The unitary nature of the energy problem is discussed on p. 26. Of course, the point made with respect to geographical diversification of small telephone, water, and electric companies applies to small gas companies as well.

D. Management and Skilled Personnel

Another argument frequently made in behalf of diversification by utilities is that only through diversification can top-quality management (or other skilled personnel) be attracted and retained by utilities. Furthermore, managerial and other skills are to some degree transferable and utility operations may gain from insights derived from experience with non-utility

* In requiring such separation under the Public Utility Holding Company Act, the SEC sometimes prevents mergers of electric companies subject to its jurisdiction which would be desirable on other grounds, because the merging companies are not prepared to divest themselves of their gas properties as a condition to obtaining SEC approval of the merger. This policy may have had merit in a period of ample gas supply and unrestricted competition between gas and electric services, but it makes doubtful sense today.

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operations. A counter-argument frequently made is that diversification dilutes managerial attention, and, to the extent management is concerned with regulated operations, utility operations suffer. To some degree the arguments cancel one another out. However, there are a number of factors which are worth mentioning pertaining to various aspects of this debate.

First, it can hardly be argued that utility operations under contemporary conditions provide inadequate challenges for management. To provide our country with adequate supplies of electricity, gas, telecommunications and water will provide awesome challenges for utility managements in the years ahead.

Second, although it may be true that a conglomerate may appear more dynamic and glamorous than a public utility from the vantage point of some new management prospects, the point is largely irrelevant. It hardly profits the gas department of a diversified company to add a bright new man to its roster whose interests lie in the electronics area. If the gas department is intrinsically interesting, company recruiters ought to be able to get the point across during the recruitment process; and if it is not, staffing the gas department with men lured to the company by the attractions of the electronics program is not likely to be helpful in the long run.

Third, as discussed below, it is likely that most utility functions will become increasingly diversified within themselves. This, too, should add to the attractiveness of utility positions, as well as affording opportunities for cross-fertilization of ideas.

Finally, while there is no denying that a skill or insight or contact obtained in one department may be beneficial elsewhere, for example, that the overseas activities of some diversified natural gas pipelines assisted them in implementing programs to import LNG, the benefits are haphazard at best. Considering the availability of consulting firms, opportunities for contacts among various professionals as well as among co-workers, and the internal diversification discussed below, there is serious question as to whether the game is worth the candle.

Here the counter-arguments about fragmentation of management attention become significant. Returning to the interstate gas transmission companies, may it not be that the possible gain from the operations of diversified activities was less than the gain that might have been realized if the pipeline managements had devoted their undivided attention to assuring adequate gas supplies?

There is another, and perhaps more subtle, aspect to the impact of diversification upon utility management. Because of tradition or necessity, utility managements have become deeply conscious of their service obligations. Despite inadequacies which have appeared from time to time, most utility managements place great emphasis upon the continued rendition of safe and adequate service. The same tradition is not evident in the operations of conglomerates generally, and it would be unsurprising and unfortunate if, as a result of diversification, utility managements were to become less sensitive to their service responsibilities.

The qualification noted in connection with financing applies here also. There may well be utilities so small that the attraction of competent management and skilled personnel would be exceedingly difficult, if not impossible. The most appropriate response, as noted above, is joinder with a specialized holding company, which would also afford the advantages of geographical diversification, financial strength, and appropriate size for raising capital.

E. Economical Use of Resources

The previous headings have considered two kinds of resources: capital, and managerial and other skilled personnel. But a utility obviously possesses other resources as well, including production facilities, distribution facilities, technological expertise, and research resources. As in the preceding examples, a means should be found to achieve economical use of a utility's resources. Two problems should be distinguished before reaching any general conclusions.

1. *Problem of size.* A utility may be too small to take advantage of economies in accounting, warehousing, procurement and the like. The most suitable answer, for the reasons given above, may be merger with a neighboring company, or a specialized holding company.

2. *Joint products, by-products, and complementary services.* The area of joint products, by-products, sources of supply, and complementary services is not one where complete and comprehensive guidelines can be provided. However, three factors are important in determining whether an activity is a suitable one for a utility to undertake:

(a) The activity should be functionally related to the utility activity. Thus, it would be appropriate for an electric company, under this criterion, to procure a source of fuel supply by mining coal and running a railroad from the mine to its generating station. It may even be justifiable for the electric company to sell some small amounts of coal to others, or to provide rail transportation for others, as an incident to providing fuel for itself. Justification for an electric company entering the coal or railroad businesses on a scale or in a way not functionally related to the primary business would need to stand on an entirely different footing.

The question raised in this report with respect to various types of diversification are not intended to reflect adversely upon functional integration of operations to achieve maximum economies. It is only when functions are wholly unrelated (or related in a way so tenuous that integrated ownership offers no advantages over separate ownership) that criticism is expressed. Indeed, in the areas involving functional relationships it is

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anticipated that diversification will (and should) tend to increase rather than decrease.

(b) The activity should not approach in size the utility operation. Thus a gas company legitimately may explore for new gas deposits in order to augment its supply. It also properly may sell liquid hydrocarbons extracted from the gas prior to its transmission. But the functional relation should not be carried to the point of using the search for gas as a springboard for establishing a general oil business or petrochemical business. The oil and the liquid hydrocarbons can be sold to be exploited by others without impairing the operations either of the company or the economy as a whole.

(c) The activity should not violate antitrust standards. For example, the FCC has concluded that telephone companies should be limited in their involvement in cable television and data transmission, for reasons that need not be elaborated here. In general, these considerations go beyond the scope of this study and will not be further pursued in this report (except the question of combination gas and electric companies).

3. *General Conclusions.*

Limited diversification, such as support functions or utility related activities, may be advantageous to the utility consumer and the utility investor. However, due to the unique role of utilities in society there is little justification for a utility entering vertically integrated activities on a large scale relative to its utility investment, functions, and responsibilities.

Montana Power Company's investment in coal reserves may be a good illustration for discussion purposes, without intending any fixed conclusions. Through a wholly-owned subsidiary the company has reserves of some one billion tons of low-sulphur coal. In addition to assuring Montana Power of long-term fuel supplies the coal subsidiary also sells coal to other buyers. There is at least the possibility that the coal business could surpass the utility business in size and importance to management.

Before such a situation develops, it would seem appropriate to consider whether it would not be better to spin off the coal business to the stockholders and have it operate as an independent entity rather than as a subsidiary of the utility. Montana Power claims that the net income from sale of coal to others indirectly supports the utility operation by allowing "the company to borrow money at more attractive interest rates than would otherwise be the case". As discussed in this report the risk associated with non-utility activities is different from that associated with utility activities and successful diversification does not necessarily mean lower costs.

E. Possibilities for the Future

The provision of energy is regarded increasingly as a unitary problem. Accordingly, the joinder of electric and gas distribution companies to afford

greater flexibility in the use of limited gas supplies and electric capacity appears to be in the public interest. While competition between gas and electric supply has positive features, the reduction or elimination of such competition—in a time of a gas shortage and an even more general energy shortage—would not be entirely harmful, at least insofar as curtailment of promotion of the sale of gas and electricity is concerned. At the same time, unified control allows the combination company, after serving residential gas customers, to determine whether—in light of the needs of gas customers (residential and commercial, present and future), the needs of electric customers, and the problem of air pollution—its limited supplies of gas should be diverted to storage, utilized for electric generation, or utilized by various non-residential classes of gas customers. Furthermore, both gas and electric operations have a vital interest in developing and implementing processes for the gasification of coal, one of the nation's most pressing energy priorities, although the process of gasification for gas transmission and distribution may not be the same as the process to gasify coal for boiler fuel.

The provision of electricity is increasingly linked to environmental considerations. Thus, it would not be surprising to find power companies involved in solid waste disposal, in managing recreational facilities integrated with power sites (including cooling ponds and transmission rights of way), and in enterprises such as fisheries making productive use of thermal discharges to waterways. Such involvements probably should be limited to pilot operations, and in any case ancillary activities should not achieve such dimensions that the tail wags the dog.

In other industries as well—particularly gas supply and telecommunications—it is anticipated that the provision of utility services will involve changing industrial configurations to meet new conditions of supply, demand and technology. Within the guidelines indicated above, it is anticipated that the industries will adapt with requisite flexibility and ingenuity.

Reference already has been made to the relation between real estate developments and new water companies. The problems associated with this form of diversification can be handled by the regulatory commissions without undue difficulty and do not require special consideration.

G. The Special Situation of Publicly Supported Housing.

One form of diversification that requires special consideration is public utility involvement in urban redevelopment, particularly ownership and operation of low and middle income housing. The critical shortage of low and moderate income housing coupled with the lack of sponsors to build the needed housing creates an opportunity for socially conscious enterprises. The social need for such housing must be considered in determining to what extent utilities should contribute to ease the shortage. The common good achieved for the community and utility in revitalizing the towns and cities where the utilities function make them logical candidates for the task. Some

utilities have proceeded with such ventures with local regulatory approval, and federal and local housing agencies favor such involvement. The SEC has ruled that public utility holding companies and their subsidiaries may not engage in this type of diversified activity, but since the SEC decision rested on an interpretation of the Public Utility Holding Company Act it should not be taken as an evaluation of the merits of the issue.

The two arguments for utility involvement, aside from the public interest that more housing be constructed for low and middle income families, are:

(1) Public utilities, because of the limitations of their franchises and the immobility of their invested capital, have a unique interest in the quality of the areas they serve. If the area deteriorates, the market for the utility's services will likewise deteriorate.

(2) Because of tax advantages associated with publicly supported low and middle income housing, the profitability of the ventures is assured and there is little risk of burdening the utility's customers with losses incident to the housing ventures.

These arguments have merit; however, there are significant countervailing considerations:

(1) While there undoubtedly is a need for more housing, there is no reason for believing that public utilities are uniquely qualified to fulfill this need. Organizational ability is not enough. The problems of operating managements are even more difficult. Most housing experts agree that resolution of the housing problem requires, not merely the construction of new units, but also skilled operation and maintenance of those units, a particularly difficult task and one that may require the sponsor's involvement over a prolonged period.

(2) Public utilities have an interest in the areas they serve, both from the vantage point of social responsibility and financial involvement. It is natural and desirable that utilities should wish to help in avoiding the deterioration of important parts of their service areas because of decaying housing and worsening slum conditions. Nevertheless their interest in new housing must be considered in light of their overriding obligation to provide adequate utility services at reasonable rates. Performing that function properly is a significant social contribution. In the typical case, there is no real prospect that the demand for utility services will be appreciably impaired if the utility fails to become involved in providing new housing. As previously noted, the main problem is the utility's ability to meet demands made upon it. Where the housing problem constitutes a genuine threat to the economics of utility supply, the case for participation is stronger.

(3) The profitability of participation in housing projects depends to some extent on the fleetness with which the utility escapes from the ventures. A rapid exit, once the project is constructed, will assure profitability, but is this

an adequate discharge of the utility's social responsibility upon which its entry into the housing field was justified? Continued involvement in the housing venture may manifest greater social responsibility, and contribute more to the ultimate success of the housing venture, but such immersion in housing problems creates risks of diminished profitability, may produce abrasive relations with tenants in utility operated buildings, and may distract utility management from its primary function of providing utility services. All of these can have detrimental effects upon utility operations.

There is the further problem that utility involvement in housing may result in undue preference for the utility's services in the housing constructed (e.g., all-electric homes in the case of housing built by an electric company) which is not necessarily consistent with a desirable allocation of resources or minimum charges to the housing project's tenants.

All things considered, utilities would be well advised to proceed cautiously in venturing into the housing field. Utility involvement in low and middle income housing should not be prohibited, in our view, but the following guidelines are suggested:

(a) Given the magnitude of the utility's primary responsibility for providing utility services, the utility should become involved in housing enterprises only to the extent that other capable housing project sponsors are unavailable.

(b) For the same reason, the utility should limit its involvement as much as possible. A consulting role is preferable to sponsorship. Construction and subsequent disposition is preferable to continue operation and maintenance, assuming adequate arrangements can be made for operation and maintenance by others.

(c) In order to avoid misunderstanding, the utility's role should be spelled out clearly in advance. If the utility is to construct a project and then sell it to an operator, the plan should be formulated in detail and express concurrence should be obtained from all interested parties, including local governments and community groups. To sell a project upon completion may create great hostility unless such a sale has been a part of the initial understanding.

(d) In no case should a utility undertake a venture for which it lacks adequate managerial capability (or which would impair its capital resources). There may be a shortage of housing, but there is no shortage of badly constructed and badly managed housing projects. The utility's capability should be carefully assessed before any commitment is made.

There are both positive and negative aspects involved in this question. It would be appealing to emphasize the positive only. However, experience to date has indicated that the negative aspects are substantial. Problems of adverse community relations have arisen as a result of utility involvement in

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housing ventures; lack of utility expertise in housing has manifested itself; and the installation of utility services in utility-sponsored housing has usually followed the self-interest of the utilities, which is not necessarily coincident with the best interests of the tenants or of society.

One final note of caution should be added. Just as the utilities lack expertise in housing matters, so do the commissions that regulate them. It is not likely to enhance the effectiveness of public utility regulation to have regulatory commissions involved in such questions as whether housing rentals are reasonable, whether housing services are adequate, whether the utility has unfairly exploited its position in establishing the energy arrangements, or whether a sale of a housing project by a utility to another party is in the public interest.

ii. Impact of Diversification on Effectiveness of Regulation

Diversification poses several problems for regulation. One which is frequently mentioned is the difficulty of allocating costs between regulated and unregulated activities for the purpose of determining the proper costs of the regulated activity. This point has only minimal validity in the context under consideration.

Even where unregulated activities, such as fuel supply and the disposition of by-products, are closely related to the utility function, cost allocation problems are likely to be significant. Nevertheless, we have concluded that for economic and social reasons the operation of utilities in related fields of endeavor is not only desirable but probably unavoidable. The real questions center around utility involvement in unrelated ventures. Almost by definition, the problems of cost allocation, except for top management, are likely to be minimal under these circumstances. One area where diversification undoubtedly will complicate regulation is in cost of capital computations. The difficulties presented are reflected in Appendices E and F.

A somewhat more subtle problem, but one with more serious implications, involves the relationship between the regulated company and the regulatory commission representing the public. In the absence of diversification, the relation is one of mutual dependency. The regulated company needs the support of the commission (and the public) to obtain the revenues it requires to continue to provide adequate service. The commission (and the public), for their part, recognize that unless such revenues are forthcoming service is likely to be impaired.

The situation changes drastically, however, when the regulated company achieves significant diversification. The company is no longer dependent solely on the commission (and the public) for its revenues and may choose to render less than adequate service. A utility, in deciding whether to increase its investment, makes the calculation whether or not it is desirable to augment its utility operations. A conglomerate must decide which among its numerous operations would provide the greatest return on increased investment assuming a limitation on available funds. On the other side, the commission

(and the public) may be moved to irresponsible decisions on the premise that, if the company fails to derive adequate revenues from the regulated service, it can always fall back on its unregulated revenues. Neither result is inevitable, and significant diversification has occurred without impairment of the regulatory process, but all parties should be alert to the risks.

V. EFFECTIVENESS OF CONTROLS OVER DIVERSIFICATION BY PUBLIC UTILITIES

There is a need to strengthen controls over public utility diversification at both the state and federal levels.

At the federal level, the Public Utility Holding Company Act is adequate in the areas of electric power and local gas distribution, and the Western Electric Consent Decree limits diversification by the Bell System.

There is no federal control over either telephone holding companies or water holding companies, and neither can be effectively controlled by the states. It would seem desirable to subject such holding companies to federal regulation. Given its experience under the Public Utility Holding Company Act, the SEC would appear to be the most likely candidate although, in the case of telephone holding companies, the FCC also should be considered. However, the standards for telephone and water holding companies should not be the same as those applicable to gas and electric holding companies. This would permit water company affiliation with real estate developers and telephone company affiliation with equipment manufacturing and procurement operations, in the absence of specific public policies to the contrary. In particular, geographical diversification of water and telephone companies should not be discouraged. Otherwise, the approach of the SEC under the Public Utility Holding Company Act—limiting utility enterprises to utility services and functionally related operations—appears to be appropriate.

The diversification of interstate natural gas pipelines should be carefully scrutinized by the FPC, which recently has instituted a proceeding to obtain information on this matter. Whether it is too late for the Congress and the FPC to take meaningful action in this area is an open question.

On the state level, existing controls are for the most part inadequate, even though most states have authority to control the disposition of proceeds from the issuance of public utility securities. Few states have explicit authority to regulate the reinvested earnings of public utilities from their utility operations, and even fewer have explicit authority to regulate reinvested earnings derived from non-utility operations. (In some cases, states claim indirect authority over reinvested earnings despite the absence of explicit statutory authorization.) What this means is that while a utility in most states would require state regulatory approval if it sought to diversify by using the proceeds of a security issue for the purpose, in the typical situation where reinvested earnings were employed, no such approval would be required in

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most states, and in even fewer instances would approval be required if a diversified utility employed earnings from its non-jurisdictional activities.

In the case of mergers and affiliations, the pattern of controls is similarly incomplete. In many states, commissions have authority to control mergers or affiliations involving utility and non-utility enterprises. Once the merger or affiliation is consummated, however, further control by the state commission is problematical. As previously indicated, state commissions cannot practicably regulate multi-state water or telephone holding companies. Other affiliations between utility and non-utility corporations (such as a non-utility subsidiary of a utility corporation) may be subject to state control in a theoretical sense, but it is questionable whether in most instances state commission control is authorized by statute or is actually exercised. In the case of a completed merger of regulated and unregulated enterprises, the state commission faces the problem, noted above, of lack of control over the earnings of the unregulated activity–which may be employed for further diversification. A table showing existing regulatory control over non-utility diversification by state is attached as Appendix G.

The result of the present pattern of state controls is that, while many state commissions may have authority to preclude diversification by merger or affiliation in the first instance, once some measure of diversification is achieved, the process passes beyond regulatory control in most instances and further diversification can be achieved without regulatory approval. Remedying the errors of the past is even less likely. Little attention has been given to the wisdom or feasibility of requiring the separation of presently diversified public utility entities, an area in which the SEC achieved considerable success under the Public Utility Holding Company Act.

VI. CONCLUSIONS AND RECOMMENDATIONS

In view of the considerations discussed above, the Ad Hoc Committee submits the following conclusions and recommendations:

A. *State Commission Control*

State commissions should seek (if they do not already possess) adequate authority to control diversification by gas, electric, telephone and water companies subject to their jurisdiction. Such authority should include:

1. Control over the disposition of proceeds of securities issues of public utilities.

2. Control over the investment of utility funds in non-utility enterprises, without regard to whether the funds are derived from utility or non-utility operations.

3. Control over the merger or affiliation of public utilities with non-utility enterprises.

4. With respect to enterprises affiliated with local utilities and which do not operate utilities in other states, control over the further investments of such affiliates.

5. Power to order the severance of non-utility from utility operations when it is in the public interest to do so.

B. *Federal Control*

In situations where state commission control is impractical, diversification by gas, electric, telephone and water utilities should be controlled by appropriate federal agencies. Specifically:

1. Electric power companies and local gas distribution companies should continue to be subject to the Public Utility Holding Company Act where they are components of public utility holding company systems. The exemptions of presently exempt holding companies should be reexamined and, if necessary to prevent improper diversification, such exemptions should be revoked.

2. Water holding companies and telephone holding companies should be brought within the ambit of the Public Utility Holding Company Act under revised standards recognizing the special requirements of such industries, including the need for geographical diversification. In the case of telephone holding companies, the FCC may be a more appropriate regulatory agency than the SEC.

3. The Federal Power Commission should scrutinize diversification by interstate natural gas pipelines to determine whether such diversification is in the public interest, and seek additional legislation, if required, to control such diversification.

C. *Applicable Standards*

While recognizing that each case must be decided in light of the particular facts pertaining to the utility and non-utility operations in question, the following should be employed as general guidelines.

1. Utilities should be permitted to engage in non-utility operations where the latter:

(a) Are functionally related to the utility operation (e.g., sources of supply, joint products, complementary operations); and
(b) Are not overly large in relation to the utility operation; and
(c) Are within the utility's financial and managerial resources; and
(d) Do not violate antitrust laws or other public policies.

2. In addition, utilities should be permitted to participate in governmentally supported low and middle income housing projects where:
(a) No other qualified participants are available and interested; and
(b) The role of the utility in the project is clearly defined; and

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(c) The utility has the managerial and other resources to fulfill that role, as well as the support of local governments and community groups.

3. With few exceptions, utilities should not be permitted to engage in non-utility activities. Exceptions may be warranted in particular cases where:

(a) A utility of small size has no alternative to affiliation with a non-utility in order to obtain access to capital, qualified personnel or other needed resources; or

(b) Other special circumstances justify limited investments by public utilities in unrelated non-utility ventures, but such investments should not exceed 5 percent of the company's utility investment and the venture should not be one of high potential losses, so that the non-utility investment and operating lossess will not be so large as to impair the company's credit if the venture is unsuccessful. Adjustments to the capitalization, as discussed in Appendices E and F, may be appropriate to protect the utility consumers from excessive capital costs.

4. Restrictions against combination gas and electric operations, presently effected by the SEC's policies under the Public Utility Holding Company Act, should be reconsidered in light of the gas shortage and the desirability of coordinating various energy operations.

5. If holding company systems are to be permitted to retain both utility and unrelated, non-utility properties, the two types of activity should be segregated in different companies or in different holding company subsystems.

D. *Further Study*

The problems encompassed by this report are complex and are subject to the influences of changing events. It is recommended that the subject be reexamined by a NARUC Committee within five years.

EXHIBIT C

State of Wisconsin \ PUBLIC SERVICE COMMISSION

March 12, 1982

STANLEY YORK, CHAIRMAN
WILLIE J. NUNNERY, COMMISSIONER
BRANKO TERZIC, COMMISSIONER
4802 SHEBOYGAN AVENUE
P.O. BOX 7854
MADISON, WISCONSIN 53707
(608) 266-2001

The Honorable John S. R. Shad, Chairman
Securities and Exchange Commission
Washington, D.C. 20549

File No.

Dear Chairman Shad:

State regulators are concerned with the Securities and Exchange Commission's December 21 proposal to Congress that the Public Utility Holding Company Act of 1935 be repealed. At its regular winter meeting in Washington, the Executive Committee of the National Association of Regulatory Utility Commissioners passed a resolution which "requests that the United States Securities and Exchange Commission reconsider its position and that further the Congress refrain from enacting any changes in the Public Utility Holding Company Act of 1935 until State regulators have received and considered the report of the Ad Hoc Committee on Utility Diversification no later than July 1, 1982."

I am the chairman of the NARUC Ad Hoc Committee on Utility Diversification. Our committee consists of ten regulatory commissioners from nine different states. We will vigorously oppose any Congressional actions on PUHCA which do not allow for adequate input from state regulators. Once our study is completed, I expect that the committee will take a firm position on the need for the Act. This position will be communicated to all state commissions.

We will be holding hearings on the question of utility diversification in Madison, May 6 and 7. Utilities, law firms, consultants, trade associations, public counsels, citizen groups, intervenors and others are expected to present testimony on utility diversification and holding companies.

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The Honorable John S. R. Shad, Chairman
Securities and Exchange Commission
Washington, D.C. 20549
Page 2

The full text of the resolution is enclosed. I will keep you apprised of future developments.

Sincerely,

Stanley York

Stanley York
Chairman

SY:GBE:dw

Enclosure

cc: The Honorable Richard Ottinger, Member of Congress
The Honorable Edward Burke, NARUC President
The Honorable Paul Rodgers, NARUC General Counsel
Members, Ad Hoc Committee on Utility Diversification

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EXECUTIVE COMMITTEE RESOLUTION CONCERNING CONGRESSIONAL ACTION WITH RESPECT TO THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

WHEREAS, the United States Securities and Exchange Commission has unanimously recommended to the Congress that the Public Utility Holding Company Act of 1935 (PUHCA) be repealed; and

WHEREAS, members of the Congress have introduced legislation to substantially modify or repeal the Act; and

WHEREAS, many state public utility regulatory commissions rely on provisions in the Act to assist in the effective regulation of electric and gas utilities within their jurisdictions; and

WHEREAS, the contemplated changes in the Act may seriously jeopardize the ability of state commissions to regulate these utilities; and

WHEREAS, the National Association of Regulatory Utility Commissioners has appointed a special Committee of state regulators to investigate the issue of utility diversification; and

WHEREAS, this Ad Hoc Committee on Utility Diversification will explicitly consider the importance of the Public Utility Holding Company Act to effective state regulation and expects to report by summer 1982; now therefore, be it

RESOLVED, that the Executive Committee acting on behalf of the National Association of Regulatory Utility Commissioners respectfully requests that the United States Securities and Exchange Commission reconsider its position and

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that further the Congress refrain from enacting any changes in the Public Utility Holding Company Act of 1935, until State regulators have received and considered the report of the Ad Hoc Committee on Utility Diversification, no later than July 1, 1982.

# # #

Founded in 1889, the NARUC is a quasi-governmental, nonprofit organization whose members include regulatory bodies of the 50 States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands. Designed to serve the public interest by seeking to improve the quality and effectiveness of government regulation of carriers and utilities, its members play a crucial role in shaping the profile and substance of public regulation in America today.

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EXHIBIT D*

U. S. Department of Energy
Federal Energy Regulatory Commission

Automatic Adjustment Clauses in Public Utility Rate Schedules

February 1982

A Staff Report on the
Implementation of Section 208
of the Public Utility Regulatory
Policies Act of 1978

* Consists of pages 68-72, 187-199 of this staff report.

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identified with utilities having captive coal operations, that is, coal supply operations in affiliate companies. 9/

Captive coal is rapidly increasing in importance as a source of fuel for the electric utilities. In 1965, 13 million tons or about 6 percent of all coal used by electric utilities came from captive mines (Table VI-6). In 1978, captive coal deliveries totaled 67 million tons, or 14 percent of total coal deliveries to the electric utilities. Captive coal production is projected to reach 143 million tons by 1985, when it will account for 20 percent of the projected 1985 total utility coal consumption of 733 million tons.

Table VI-6

The Role of Captive Coal in Total Coal Deliveries to Electric Utilities

	1965	1978	1985 (Projected)
Total Coal Deliveries To Electric Utilities, (million tons)	243.6 a/	476.2 b/	733.1 c/
East of Miss. River	N.A.	334.7	433.2
West of Miss. River	N.A.	141.5	299.9
Captive Coal Deliveries, (million tons)	13.4 a/	66.8 b/	143.2 b/
East of Miss. River	N.A.	29.5	45.7
West of Miss. River	N.A.	37.3	97.5
Ratio of Captive to Total, %	5.5	14.0	19.5
East of Miss. River	N.A.	8.8	10.5
West of Miss. River	N.A.	26.4	32.5

a/ Source: National Coal Association, Coal Facts 1974-1975.

b/ Source: Federal Power Commission, Electric Utilities Captive Coal Operations, June 1977, and update of the statistical information in the report through June 1979.

c/ Source: National Electric Reliability Council, 1980 Summary of Projected Peak Demand, Generating Capability, and Fossil Fuel Requirements for the Regional Reliability Councils of NERC, July 1980.

9/ Captive coal includes outright ownership and operation of the coal mining facility by an electric utility, or utility ownership of the coal reserves with an arrangement with an independent mining company to mine the coal, or as in a few cases in which the utility has a financial arrangement with a coal mining company such that something other than an arms-length transaction is involved.

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The preliminary findings are that: (1) captive coal prices are, on the average, significantly higher than comparable non-captive coal prices, (2) captive coal mines appear to be operating less efficiently than comparable noncaptive coal mines; and (3) regulation of electric utility affiliated coal operations may be inadequate to assure the efficient management of captive mines and the reasonableness of the captive coal prices.

Captive vs. Non-Captive Coal Prices

In 1978, captive coal prices for utilities located east of the Mississippi River averaged 140.5 cents per million Btu (FOB utility) compared to 122.3 cents per million Btu for comparable non-captive coal. The finding that captive coal prices are generally higher than non-captive coal prices agrees with the findings of earlier Commission studies on captive coal. 10/ Additional discussion of captive coal prices is given in Appendix B.

In 1978 the electric utility industry operated 110 coal mines nationwide. Staff analysis of the 73 captive coal mines located east of the Mississippi River resulted in the conclusion that these 73 captive mines (64 of which produced coal in 1979) were being operated much less efficiently than comparable non-captive coal mines. (The measure of efficiency used in this comparison was a productivity index of tons per man-day.) Analysis showed that the 64 captive mines had an average productivity index of 11.6 tons per man-day, significantly lower than the 16.6 tons per man-day average productivity index for the comparable non-captive mines. 11/

Regulation

The authority to regulate the transfer price of the captive coal used by electric utilities is divided among State Public Utility Commissions and two Federal agencies, the Federal Energy Regulatory Commission (FERC) and the Securities and Exchange Commission (SEC).

The State Public Utility Commissions have jurisdiction over all intrastate retail sales of electricity (approximately 90 percent of total revenues from electricity sales of privately owned utilities in the U.S.). Many of the State PUC's have limited

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10/ Federal Power Commission, Electric Utilities' Captive Coal Operations, June 1977. The statistical information in the report has been updated through June 1979 by the Federal Energy Regulatory Commission Staff.

11/ See U.S. Department of Energy, Coal Competition: Prospects for the 1980's, Draft Report, January 1981, Chapter VIII.

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resources with which to regulate affiliate coal operation effectively. The Federal Energy Regulatory Commission has jurisdiction over wholesale and interstate sales of electricity. This jurisdiction includes authority to determine in rate cases the reasonableness of captive coal prices. The SEC has the authority to regulate holding companies and their affiliate operations to protect the investors in these companies. 12/ At this time the SEC has a limited involvement in regulating captive coal since only 13 utilities of the 39 utilities involved in captive coal in 1978 are members of holding companies (however, these 13 utilities used almost 50 percent of all the captive coal produced in 1978).

The relevant FERC regulation is Section 35.14, paragraph 7 of the Code of Federal Regulations which states:

> "... Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause ..."

The staff review indicates that deferral to another regulatory body, as provided in Section 35.14, may not provide adequate assurance of reasonable rates and may not alert the Commission to situations involving unreasonable rates. An earlier staff review of State commission regulations of affiliated fuel operations indicated that the extent and effectiveness of these regulations vary widely among the states. 13/

The major growth in captive coal will be for utilities west of the Mississippi River. In 1978 the Western utilities used 37 million tons, or 55 percent, of the total 67 million tons of captive coal. By 1985, utilities located in the West are projected to use 98 million tons, or about 68 percent, of the projected total captive coal production of 143 million tons.

The increasing use of captive coal by the electric utility industry is due both to expansion of captive operations by utilities that presently use captive coal, as well as to additional utilities acquiring interests in coal reserves and production. In December 1975, the utilities controlled 11.6 billion tons of recoverable coal reserves; by June 1979, the total had reached 13.5 billion tons. Most of the increase in utility coal reserve holdings has been in the Western coal regions. In 1975, 66 percent of utility-owned recoverable coal reserves were located in the West; by 1979, 70 percent of the total was in the West.

12/ This authority was given to the SEC under the Public Utilities Holding Company Act of 1935.

13/ A study on Electric Utility Associate Fuel Companies (State Regulatory Oversight) was prepared for the FERC in September 1980. A summary of that study is included in Appendix B.

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Chapter VII

Conclusions

Use of Automatic Adjustments

The great majority of rate schedules for wholesale electric service provide for automatic adjustment of rates based on changes in cost, either in the form of a limited specific adjustment, as with a fuel adjustment clause, or in the form of rates that are partly adjustable on the basis of incremental energy cost or fully adjustable on the basis of all costs, the latter usually applying to service from a specific facility. For transactions among large privately-owned utilities, incremental energy cost rates (IECR's) predominate, and rate schedules of this type constitute, by far, the largest group among the types on file at the Commission. Rates based on comprehensive costs of service (CCFR's), while much fewer in number, are widely used in situations where utilities seek to share certain risks of ownership of facilities without joint ownership.

Rate schedules containing fuel adjustment clauses (FAC's) predominate (77%) in full or partial requirements service provided by privately-owned utilities to smaller utilities such as municipally-owned or cooperatively-owned utilities and small privately-owned utilities.

Incentive Effects

The Commission Staff review provided no direct indication that the presence of automatic adjustments leads to utility actions that are adverse to the efficient use of resources. Qualitative analysis of incentive effects provides a basis for the conjecture that AAC's may reduce utility management incentives toward efficiency. It would not be possible to say, based on this analysis, that, in the words of Section 208, ". . . each such clause effectively provides incentives for efficient use of resources. . . " But quantitative evaluation, including a statistical analysis of FAC features and utility costs, does not show a measurable effect attributable to the absence or weakening of these incentives in the utilities' wholesale business. 1/

Variability and Predictability

The material in Chapter V demonstrates that fuel costs are generally subject to periodic fluctuations and are not susceptible to precise determination in rate cases prior to the time such costs are incurred. The use of FAC's in wholesale rate schedules appears to be

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1/ As noted in Chapter IV, statistical analysis of retail clauses alone indicates a small effect in the form of a fuel input distortion associated with use of an FAC. The distortion indicated amounts to an approximately 0.3% increase in total production cost for a 10% increase in cost recoverability resulting from more liberal clause features.

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an effective means of reflecting variable costs of service in rates, of maintaining a desirable stability in utilities' recovery of incurred costs, and of avoiding an unproductive increase in rate case proceedings.

The two types of fully adjustable rates, IECR's and CCFR's, are structured to reflect certain costs that, while variable, are relatively predictable. The primary purpose of these rates, however, is to provide an equitable basis for types of inter-utility transactions that appear desirable to encourage: in the case of IECR's, the transactions tend to facilitate operation of interconnected systems at minimum total cost; in the case of CCFR's, the transactions tend to encourage coordination of plans for increases in capacity.

Utility Practices

The staff review disclosed a number of practices related to fuel procurement that appear to reflect a degree of utility management laxity with respect to minimizing delivered cost of fuel. There is not, however, any indication that the prevalence of such practices is related to the presence of FAC's in a given utility's wholesale rate schedules.

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Statistical Analysis of Captive vs. Non-captive Coal Prices

It was determined that to make a valid comparison of captive and non-captive coal prices the analysis should be conducted at the regional coal market level rather than at the national level. That is, a utility and its captive coal prices were compared to the non-captive coal prices found in the regional coal market in which the individual utility does business. 15/ The major benefit of using regional price comparisons is that the regional coal markets vary appreciably in their coal supply and demand conditions, and this approach will compare only prices affected by and resulting from similar market conditions. The delineation of regional coal markets is discussed earlier in this Appendix; the result is shown on the map on page 13.

In addition to aggregating the coal price data by regional coal market a second criterion was established that only long-term contract coal prices would be used for the non-captive prices. This criterion was established because these contracts fulfill basically the same role as captive coal of giving the utility a long-term committed supply of coal.

The source of the coal price data used in the analysis was the individual utility responses to Commission staff requests for information on coal contract prices as part of the investigation in Docket IN79-6. The coal price data from FERC was for calendar year 1978.

After analyzing the coal price data as it had been aggregated by regional coal markets, the conclusion was drawn that a valid statistical analysis of captive and non-captive coal prices could be conducted only with the data from Coal Market Region 1 (Eastern). This conclusion was based both on the quantity and quality of the data and the nature of the individual coal regions. Coal Market Regions 3 and 4 were not considered suitable for statistical analysis because both areas, being relatively small coal users, did not have enough captive and non-captive coal price records to make a valid comparison. Coal Market Region 2 was not considered suitable for analysis because inclusion of transportation costs in the coal price data would heavily bias the analysis in favor of the captive mines. Most of the captive mines in Region 2 are mine-mouth operations and would have minimal transportation costs included in their coal prices. In contrast, a large portion of the non-captive coal traded in Region 2 travels long distances from mine to power plant and has large transportation costs which would significantly increase the FOB plant price of the non-captive coal.

15/ See footnote 9 on page 165.

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In an analysis of coal prices in Coal Market Region 1 the problem of having transportation costs included in the coal prices becomes much less significant than is the case in Region 2. The coal fields run throughout much of Region 1 with the mines generally much closer to the power plants; consequently, transportation costs are a smaller part of Region 1 FOB plant prices. Furthermore, the effect of using FOB plant prices in the analysis would probably slightly favor the captive coal prices since many of the captive utilities are located within the coal producing areas and would have transportation costs lower than the regional average.

In addition to having the transportation costs included in the coal prices there are other factors which may bias the comparison either in favor of the captive or non-captive prices. The most important factors are:

(1) Ideally each captive coal contract should be compared only to non-captive coal contracts signed during the same period of time since newer contracts would usually have higher prices due to the increasing costs of opening new mines. However, the contract start-up date was not known at the time of the analysis and therefore the captive coal prices were compared to all non-captive coal prices. Since the time the analysis was conducted, additional information became available which shows that the average start-up date for the captive contracts was 1967 while the average for the non-captive contracts was 1975. 16/ Based on these average contract start-up dates it would appear that the analysis would have a downward bias in favor of the captive coal prices.

(2) The individual contract data was not identified by method of mining operation used to extract the coal (strip or underground mining) and therefore the analysis could not be separated by method of mining. In general, strip mines are less expensive to operate and should have lower prices than underground mines. Consequently, if captive or non-captive coal is disproportionately mined by strip or underground methods, the group which is more heavily produced from strip mines will probably have a downward bias on its average prices. Computations

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16/ It would appear that captive coal contracts being, on the average, of older vintage than non-captive contracts is logically inconsistent with the fact that captive coal production is increasing faster than non-captive production. However this is not the case here since this analysis is limited to captive utilities located in the East and, as can be seen from Table VI-6, most of the growth in captive coal is in the West with relatively small additional development by Eastern captive utilities.

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made from other data sources 17/ indicate that 30 percent of the captive coal was strip-mined while 65 percent of the non-captive coal was strip-mined. Based on these percentages it appears that there would be a downward bias in favor of the non-captive coal prices.

Results of the Comparison of Captive vs. Non-Captive Coal Prices

The comparison of captive and non-captive coal prices from Coal Market Region 1 was made using the statistical testing method called the "t-test".

The data on captive and non-captive coal prices was aggregated by utility so that there was one weighted-average price per utility for all of that utility's non-captive coal purchases, and, if that utility also bought captive coal it would have a second weighted-average price for its captive coal. As a result of these utility-by-utility aggregations the data base used in the t-test consisted of 53 non-captive coal prices and 16 captive coal prices.

The results of the statistical analysis, given below, show that captive coal prices were significantly higher than non-captive coal prices.

Captive Coal Prices	Non-Captive Coal Prices	Level of Significance
140.5	122.3	.907

Summary of Report on State Regulatory Oversight of Electric Utility Associate Fuel Companies

This section summarizes a study 18/ on the degree of State Public Utility Commissions (PUC) regulation of transactions between electric utilities and their affiliates involved in any phase of fuel supply. The study was based upon the results of a PUC survey on such oversight. Three basic questions were addressed in the survey:

17/ The 1978 captive coal strip vs. underground mining ratio was calculated from the data base created to analyze the technological efficiency of captive mines reported in Chapter VIII of Coal Competition: Prospects for the 1980's, U.S. Department of Energy Draft Report, January 1981.

18/ "Study of Electric Utility Associate Fuel Companies (State Regulatory Oversight)," prepared by Sheldon L. Bierman pursuant to Purchase Order No. DE-AP39 80RC10248.00, September 1980.

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(1) Have Commissions developed structured policies and programs regarding utility-fuel affiliate relationships?

(2) What regulatory approach do Commissions use?

(3) What issues do the Commissions emphasize in regulation?

Thirty-six states in the contiguous United States have jurisdictional utilities with fuel affiliates and the survey responses from these states indicate wide variations in regulatory efforts.

Results

Since transactions between a utility and its affiliate fuel company do not usually result from a process of arms-length bargaining by independent parties, each seeking to obtain the most advantageous arrangement for itself, the possibility exists that affiliate profits may exceed reasonable levels, or that subsidiary operations may be technically inefficient, and consequently, utilities will be burdened with excessively high fuel prices.

In each area addressed in this survey, in initial regulatory policy development, in regulatory approach, and in the emphasis of regulation, the efforts of State PUC's appear to be limited. Most factors that were examined in the survey were not considered by about one half to more than two-thirds of the 36 Commissions. In some states, Commissions appear to lack the authority to deal with affiliates. Many PUC's also lack the resources necessary to undertake the additional responsibilities of thorough investigations. Inadequate reporting and recording requirements and the resulting lack of systematic information contribute to regulatory problems.

State-by-State Survey

The survey requested data on whether or not PUC's have policies or programs to regulate the transactions between utilities and their fuel affiliates. While 19 of the 36 Commissions involved do have established policies, only 15 of them have developed plans or procedures for systematic regulation. Eight of these commissions have designed programs specifically for the regulation of utility-affiliate transactions while the rest of the programs are attached to rate and fuel adjustment clause cases. Thus, only about half of the Commissions have any type of regulatory policy and less than half have established programs to regulate utility-fuel affiliate relationships.

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Methods of Regulation

Some indication of degree of regulation is the reporting and record-keeping requirement by the Commissions. Fifteen Commissions, less than half, require utilities to report on one or more subjects. In only two of the eight categories for which information was requested did half or more of the Commissions require recordkeeping.

Some Commissions have determined that their approval is required for certain types of utility-affiliate transactions. Although approval of a transaction would be a stronger regulatory requirement than recordkeeping of the transaction, less than half of the Commissions require approval of any of the six types of transactions for which information was requested.

Regulatory Emphasis

The major regulatory emphasis is on pricing: what the affiliate charges the utilities, what the return on investment is to the utility and to the affiliate; what service charges the utility may pay the affiliate. Records are required on pricing, return on investment and service charges in a relatively large number of states. Approval of prices by Commissions is required in 14 states.

In the regulation of utility-affiliate relationships some Commissions focus on the business practices of affiliate fuel companies, as accounting techniques, external financing, directorate interlocks, and the physical operations.

Another focus of regulation is on the contractual agreements between utilities and their affiliates. Approval of agreements is a requirement in 12 states. Records of agreements are required in 20 states; however, records of compliance with agreements are required in only 11 states.

A fourth area of regulatory emphasis is on the opportunity for outside competitors to bid against affiliates. Bidding and competition issues are not covered in reporting requirements and receive little attention in recordkeeping and approval requirements.

The following six tables (taken from the original study, but without the accompanying extensive comments) describe the various activities and extent of PUC regulation of transactions between electric utilities and their fuel affiliates.

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TABLE B-16

State Commissions With A Policy Plan or Program of Regulation of Utility Fuel Affiliates

State Commissions	Commissions with a Policy Respecting Utility-Affiliate Transactions		Commission Permission Required to Form Fuel Affiliate		Commission With Plan, Program or Procedures for Regulation of Utility-Affiliate Transactions	
	Yes	No	Yes	No	Yes	No
Arizona	X			X		X
Arkansas	X		X		X	
California	X			X		X
Connecticut		X	X			X
Florida	X			X	X	
Idaho	X (in orders)			X	In rate cases	
Illinois	X		X		X	
Louisiana	X			X	X	
Maryland		X	X			X
Massachusetts		X	X(direct affiliate only)			X
Michigan	X			X	In rate cases	
Minnesota */	X			X		X
Montana	(developing)			X		X
New York	X		X			X
North Carolina		X	X		Rate & FAC hearings	
North Dakota	X			X	" " "	
Ohio	X		X		X	
Oregon	X			X	X	
Pennsylvania	X		X		X	
South Carolina	X			X	X	
South Dakota	X			X	X	
Texas	X			X	In rate cases	
West Virginia	X		X		X	
Wisconsin	X		X			X

*/ The Minnesota Commission has a policy although no utilities under its jurisdiction have active fuel affiliates.

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TABLE B-17A

Reporting Requirements for Utility-Affiliate Fuel Companies (States With a Policy on Electric Utility Arrangements With Fuel Affiliates)

State	Arrangements & Transactions		Affiliate External Financing		Directorate Interlocks of Affiliate Fuel Companies		Operational Aspects	
	Yes	No	Yes	No	Yes	No	Yes	No
Arizona		X		X		X		X
Arkansas	X		X			X		X
California		X		X		X	X	
Florida		X		X		X		X
Idaho		X (in rate cases)		X		X		X
Illinois	X		X			X	X	
Louisiana		X		X		X		X
Michigan		X		X		X	X	
Montana		X		X		X		X
New York	X		X			X	X	
North Dakota		X		X		X		X
Ohio	X		X		X		X	
Oregon	X		X			X		X
Pennsylvania	X		X		X		X	
South Carolina	X		X			X	X	
South Dakota		X		X		X		X
Texas	X		X			X		X
West Virginia	X		X			X	X	
Wisconsin	X		X		X		X	
Wyoming	X		X		X		X	
Total*/	11	9	11	9	4	16	10	10

*/ Minnesota's State Utility Commission has a policy although no electric utilities under its jurisdiction have active fuel affiliates.

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TABLE B-17B

Reporting Requirements of State Utility Commissions (States Without a Policy About Electric Utility Arrangements with Fuel Affiliates)

State Utility Commission	Arrangements & Transactions		Affiliates External Financing		Directorate Interlocks of Affiliates		Affiliate Operational Aspects	
	No	Yes	No	Yes	No	Yes	No	Yes
Colorado	X		X		X		X	
Connecticut	X			X	X			X
Delaware	X		X		X		X	
Indiana	X		X		X		X	
Iowa	X		X		X		X	
Maryland		X		X		X	X	
Massachusetts		X	X		X		X	
Mississippi	X		X		X		X	
Missouri	X		X		X		X	
Nevada	X		X		X		X	
New Jersey	X		X		X			Storage
New Mexico	X		X		X		X	
North Carolina		X		X		X		X
Oklahoma	X		X		X		X	
Virginia		X		X	X		X	
Washington	X		X		X		X	
Totals	12	4	12	4	14	2	13	3
Total for Tables 17A & 17B	21	15	21	15	30	6	23	13

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TABLE B-18

STATE UTILITY COMMISSION
RECORD KEEPING REQUIREMENTS

State	Utility-Affiliate Agreement		Pricing by Affiliate to Utility		Bidding Prior to Procurement from Affiliate		Accounting by Affiliate		Utility-Affiliate Transactions		Investment or Return on Investment in Affiliate		Affiliate Service Charges to Utilities		Compliance with Agreements	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
Arizona		X		X		X		X		X		X		X		X
Arkansas	X		X			X		X		X*		X	X			X
California	X		X		X		X		X		X		X			X
Colorado		X		X		X		X		X		X		X		X
Connecticut	X		X			X	X		X			X		X		X
Delaware		X		X		X		X		X		X		X		X
Florida	X		X		X			X		X	X		X		X	
Idaho	X			X		X		X		X		X		X		X
Illinois	X		X			X	X			X		X	X			X
Indiana	X		X			X		X		X		X		X		X
Iowa		X		X		X		X		X		X		X		X
Louisiana		X	X			X	X		X		X		X		X	
Maryland	X			X		X		X		X		X	X			X
Massachusetts	X			X		X		X		X		X		X		X
Michigan		X	X			X		X		X		X	X		X	
Minnesota	X		X		X		X			X		X	X			X
Mississippi		X		X		X		X		X		X		X		X
Missouri		X		X		X		X		X		X		X		X
Montana		X		X		X		X		X	X		X		X	
Nevada		X		X		X		X		X		X		X		X
New Jersey		X		X		X		X		X		X		X		X
New Mexico		X		X		X		X		X		X		X		X

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TABLE B-18 (cont.)

STATE UTILITY COMMISSION
RECORD KEEPING REQUIREMENTS

State	Utility-Affiliate Agreement		Pricing by Affiliate to Utility		Bidding Prior to Procurement from Affiliate		Accounting by Affiliate		Utility-Affiliate Transactions		Investment or Return on Investment in Affiliate		Affiliate Service Charges to Utilities		Compliance with Agreements	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
New York	X			X		X		X		X		X		X		X
North Carolina		X		X		X		X		X		X		X		X
North Dakota	X		X			X	X			X		X	X		X	
Ohio	X		X		X		X		X			X		X	X	
Oklahoma		X		X		X		X		X		X		X		X
Oregon	X		X			X		X		X		X	X			X
Pennsylvania	X		X		X		X		X		X			X	X	
Rhode Island		X		X		X	X			X		X		X		X
South Carolina	X		X		X		X		X		X			X	X	
South Dakota		X		X		X		X		X		X		X		X
Texas		X		X		X		X		X		X		X		X
Virginia			X			X		X		X	X			X	X	
Washington		X		X		X		X		X		X		X		X
West Virginia	X		X			X	X		X		X		X			X
Wisconsin	X		X			X	X		X		X		X		X	
Wyoming	X		X		X		X		X		X		X		X	
Totals	20	18	18	20	7	31	13	25	9	29	10	28	14	24	11	27

*Natural gas service

Note to Table 18: Among the 38 state commissions tabulated, two, those of Rhode Island and Minnesota, do not regulate electric utilities that have active fuel affiliates. These states are included because they have some reporting requirements.

TABLE B-19

STATE COMMISSION ORDERS
Utility - Affiliate Transactions

State Utility Commission*	Rate Case Opinion	Fuel Adjustment Clause Review	Affiliate Financing Request	Regulation
Arizona	X			
Arkansas	X			
California	X		X	
Colorado				
Connecticut			X	X
Florida				
Idaho	X			
Illinois			X	
Indiana		X		
Kentucky**				X
Louisiana	X	X		
Massachusetts				
Michigan	X		X	
Minnesota**				
Mississippi		X		
Montana	X			
New Mexico				Proposed
New York	X		X	
No. Carolina	X	X	X	
No. Dakota				
Ohio		X	X	X
Oregon	X		X	
Pennsylvania				X & Proposed
So. Carolina	X	X		X
So. Dakota	X			
Texas	X			
Virginia		X	X	
Washington	X			
West Virginia	X	X		
Wisconsin	X			
Wyoming	Pending		X	
Total	16 plus 1 pending	9	9	5 2 pending

* Omits states for which questionnaire was inapplicable.
** States without utilities with fuel-affiliates.

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TABLE B-20

ACTIVITY BY STAFF

In State Regulatory Proceedings
Utility - Fuel Affiliate Transactions

State Utility Commission	Audits of Affiliate	Review of Utility - Affiliate Transactions	Letter Orders
Arizona			
Arkansas	X		
California	X	X	
Colorado			
Connecticut		X	
Delaware			
Florida			X
Idaho	X	X	X
Illinois		X	
Indiana			
Iowa			
Kentucky			
Louisiana	X		X
Maryland			
Massachusetts			
Michigan			
Minnesota			
Mississippi			
Missouri			
Montana			
Nevada			
New Jersey			
New Mexico		Proposed	
New York			
No. Carolina	X	X	X
No. Dakota			
Ohio	X	X	
Oklahoma			
Oregon		X	
Pennsylvania			
Rhode Island			
So. Carolina	X	X	
So. Dakota		X	
Texas	X		
Utah			
Virginia		X	
Washington	X		
West Virginia	X	X	
Wisconsin		X	X
Wyoming			
Total	10	12 plus 1 pending	5

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TABLE B-21

Aspects of Transactions Between Utilities and Their Fuel Affiliates for Which State Regulatory Approval is Required

State Utility Commission	Agreements	Pricing	Procurement Plan Competitive Opportunities	Accounting	Transactions	Service Charges to Utility
Arizona	X					
Arkansas					X	
California		X				
Connecticut		X		X		
Florida		X		X		
Idaho						
Illinois	X	X		X	Some reports	X
Louisiana		X		X		X
New Mexico	Proposed					
New York	X	X		X		X
No. Carolina	X	X	X	X	X	X
Ohio	X	X	X	X		
Oregon	X					X
Pennsylvania	X				X	X
So. Carolina	X	X	X	X	X	X
Texas		X				
Virginia	X	X				
West Virginia	X	X		X	X	X
Wisconsin	X	X	X	X	X	X
Wyoming	X	X	X	X	X	X
Total	12 plus 1 proposed	14	6	11	8	11

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EXHIBIT E

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June 2, 1982

Alan Richardson, Esquire
Legislative Director/Counsel
American Public Power Association
2301 M Street, N.W.
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Dear Mr. Richardson:

This is in response to your solicitation of my views on the proposed repeal of the Public Utility Holding Company Act of 1935. The Holding Company Act, in my view, is a specially designed procedure to deal with antitrust questions as they arise in the electric utility industry. See, e.g., Trienens, The Utility Act as a Solution to Sherman Act Problems, 44 Ill. L. Rev. 331 (1949); Municipal Electric Ass'n of Massachusetts v. SEC, 413 F.2d 1052, 1056-57 & n. 8 (D.C. Cir. 1969). As a general matter, I would have thought it perfectly obvious that the Act furnishes a much needed bulwark against the monopolistic practices that it was, in part, fashioned to prevent. It may be argued that those practices are no longer endemic to the industry. However, the persistence of the issue of "price-squeeze" in rate cases litigated before the Federal Energy Regulatory Commission since FPC v. Conway Corp., 426 U.S. 271 (1976), indicates that the industry as a whole still honors the policies of the Sherman Act more often in the breach than in the observance.

I recently had occasion to witness the continuing potential of the Act as a remedy for Sherman Act problems in the course of a FERC rate case, Louisiana Power & Light Company, FERC Dkt. Nos. EL81-13-000 and ER81-457-000 */. That case concerned Louisiana Power & Light's attempt to impose short-term incremental cost-based rates (of a kind appropriate for interchange transactions between generating utilities) upon LP&L's full-requirements service to the City of Winnfield, Louisiana, a nongenerating retail distribution system entirely dependent upon LP&L for bulk power. The proposed rate would have doubled or trebled Winnfield's bulk power costs and driven it out of the retail market in which it competes with LP&L.

The case presented a classic case of "price-squeeze" as defined by Judge Learned Hand in the case of Aluminum Company of America v. United States, 148 F.2d 415 (2d Cir. 1945). That is, it was shown that the ratio of the proposed

*/ 17 FERC ¶63,020 (1981) (Initial Decision); 17 FERC ¶61,230 (1981) (Order Affirming And Adopting Initial Decision).

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EXHIBIT E

price of wholesale service to Winnfield to the cost of that service was substantially greater than the price-to-cost ratio of LP&L's service to its retail customers. Just as Alcoa had priced aluminum ingot at a price so high that fabricators buying ingot from it could not possibly market finished products at a price competitive with Alcoa's price for the same products, LP&L had attempted to price wholesale power so high that Winnfield could not furnish retail service at rates competitive with LP&L's. Had LP&L succeeded, there would have been one less municipal electric system in Louisiana because Winnfield's voter-ratepayers would undoubtedly have turned their system over to LP&L in order to obtain LP&L's lower retail rate.

The latter proposition was not left to speculation. The record in the case showed that in the period 1975 through 1980 LP&L acquired no less than six competing municipal electric systems pursuant to "operating agreements" providing for a 60-year franchise and for transfer of title to LP&L, at its option, upon discharge of the system's bonded indebtedness. The proof showed that a least four of these acquisitions were accomplished by a variety of price-squeeze that has been referred to as a "Monroe" price-squeeze, after the name of the largest of the systems so acquired and the second-largest municipal system in Louisiana at the time of the takeover.

The four systems in question--those operated by the cities of Monroe, Rayville, Jonesboro, and Homer, Louisiana--each owned and operated relatively small-scale oil- or gas-fired generating units. In the mid-1970's those systems experienced service increases in fuel costs and curtailments of gas supplies. Self-generation of baseload power, therefore, became uneconomic. Each city cast about for alternatives and found that LP&L dominated the wholesale firm power market to which the cities could, as a practical matter, turn. Each requested LP&L to sell it wholesale power on terms that would allow it to continue to compete. However, LP&L declined to sell them power at rates based upon LP&L's average system costs. Instead, LP&L would deal at wholesale only on rates based upon the highest cost of fuel used in any unit furnishing power for LP&L's system in each hour, i.e. short-run incremental cost. LP&L was willing to sell power at average cost to the citizens of the cities, however, but only if the cities gave LP&L retail franchises and turned their systems over to LP&L. In Sherman Act terms, LP&L employed its market power in the upstream wholesale market to eliminate competition by the cities in the downstream retail market.

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The largest of these acquisitions--that of the City of Monroe's system--is now the subject of an investigation by the Securities & Exchange Commission under the Public Utilities Holding Company Act. Louisiana Power & Light Company, SEC Dkt. No. 70-6147. Against the background of five other acquisitions in as many years, such an investigation would seem self-evidently in the public interest.

In addition to price squeeze, another antitrust question was raised by the "Monroe" price squeezes. When LP&L took over a system, no economies were effected. LP&L simply averaged the cost of serving the new retail load with its other load, and the extra cost was passed on to its other retail customers hidden in the fuel adjustment charge. In this way, LP&L raised the price to its captive retail customers who in effect financed the acquisition.

Although I have no idea what, if anything, the SEC will do to remedy the market concentration resulting from these takeovers, it seems plain that prevention measures, such as conditioning any future acquisitions upon proof that LP&L has first offered wholesale power on reasonable terms, are in order. Such measures are precisely the kind contemplated by §10(e) of the Act as it has been interpreted by the courts. See Municipal Electric Ass'n of Massachusetts v. SEC, supra at 1060. The Act and the expertise in applying it acquired by the SEC remain critical, if underutilized, barriers to the elimination of all but that handful of municipal systems that are too large for their privately-owned competitors to swallow.

I hope all this will be of some use to you in impressing upon the Congress how serious the threat further concentration of the holding companies' grip on electric power markets remains and how important it is that those defenses against it that exists, including the Holding Companies Act, remain in place.

Very truly yours,

Wallace E. Brand

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June 4, 1982

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General Counsel
American Public Power Association
2301 M Street, N.W.
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Re: Legislation Intended To Repeal
The Public Utility Holding Company
Act of 1935.

Dear Mr. Richardson:

You have asked me to convey my views regarding the continued need for the Public Utility Holding Company Act of 1935 ("PUHCA" or "Act") and the proposed legislation which would repeal PUHCA. In my opinion, PUHCA remains of vital importance to the proper regulation of the electric and natural gas utility industries and should not be repealed. To support my conclusions, I offer the following proceedings and related matters which illustrate the need for vigorous enforcement of PUHCA.

Prior to addressing the specific proceedings which I believe fully demonstrate the continued need for PUHCA, some generalizations are appropriate. Initially, I note that the incumbent Commissioners of the Securities and Exchange Commission ("SEC") have expressed the view that the work under the Act has been completed and that PUHCA no longer serves a useful purpose. In my opinion, the current Commissioners lack a historical perspective and misread the calm waters, failing to recognize that the Act, like a dam, has created the calm. Without the Act, the crucial natural gas and electric industries would become subject to merger and take-over abuses. For example, oil companies would be free to take over electric utilities, thereby diminishing the already inadequate market competition by utilities in the purchase of oil, gas, coal and nuclear fuels. Currently registered holding companies could take advantage of their exclusive power pools and the efficiencies and economies of their bulk power resources to take over smaller companies, rather than deal fairly with them in power supply matters. Subsidiary companies could be created to siphon off benefits that should flow down to the consumers because the Act's prohibitions against unrestrained intra-system profits would be abolished. These are problems which conventional regulatory

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bodies were unable to address and control prior to the enactment of PUHCA and there is no reason to believe that existing state and federal regulators would be equal to the job today. In fact, only the SEC is capable of addressing holding company abuses and the present comparative absence of holding company abuses are only evidence of the deterrent effect of this crucial statute.

In this regard, it should be acknowledged that a few states have enacted legislation which prevents undesirable mergers and holding company proliferation. However, irrespective of such state statutes, no single state regulatory commission can effectively deal with a multistate holding company and joint state action is difficult to achieve. For this reason, I believe only the SEC can effectively regulate multi-state holding companies.

A good example of the type of abuse which could arise upon repeal of the Act would be the sale of fossil or other fuels by an oil company to its captive electric utility subsidiary. It is submitted that conventional regulatory resources are inadequate to investigate and resolve such probable holding company abuses because existing agencies lack the facilities and funds to sift through the complex data which would be created to mask the preferential fuel contracts.

As to the particular proceedings which demonstrate the continued need for and the utility of PUHCA, I have divided my response according to the functions fulfilled by the Act.

MERGERS

The enactment of PUHCA represents a Congressional determination that the extraordinary growth of holding company systems was against the public interest. By its terms, the Act abolished public utility holding companies which did not comply with the integration standards expressed in Section 11. Expansion of registered and some exempt holding companies is subject to Section 10 of the Act. This provision contains detailed requirements for any new public utility holding company expansion which are intended to nip in the bud any recreation of the circumstances that prompted enactment of the statute.

In administering Sections 10 and 11 of the Act, the Securities and Exchange Commission ("SEC") has refused to approve mergers which were not in the public interest and

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conditioned its approval of otherwise inappropriate mergers in a fashion designed to encourage competition in the utility industry between investor-owned and municipally-owned electric systems. These actions have spared the public the recreation of large, inefficient holding companies which are not amenable to effective state or federal regulation. Further, the PUHCA has encouraged a healthy plurality in the electric utility industry which would not otherwise exist.

A good example of the SEC's commendable actions in this regard is its comparatively recent disapproval of the proposed Eastern Electric Energy ("EES") merger. The New England Electric System, Boston Edison Company and Eastern Utilities Associates proposed to merge. These entities were, respectively, the second, third and seventh largest electric systems in New England and controlled more than 40% of the region's generating capacity and electric sales. After proceedings in which the antitrust division of the Justice Department was a party, the SEC spared the public the inefficiencies of bigness and ruled that the proposed merger would not "serve the public interest by tending toward the economical and efficient development of an integrated public utility system ..." within the meaning of Section 10(c)(2) of the Act. 1/ More particularly, the SEC ruled that consolidated operation of these three large holding companies would not yield operating efficiencies sufficient to meet the standards of the Act.

Of equal importance to the long-term development of a more efficient electric utility industry was the SEC's conclusion that all of the benefits attributed to the merger were available through power pooling. Of course power pools are the arrangements by which two or more utilities agree to coordinate a portion of their operations to realize maximum operating efficiency. In the context of the EES merger, the SEC concluded that the New England Power Pool offered the New England region all of the benefits of economies of scale in the generation and transmission of power with none of the burdens to the consumer resultant from the affiliation and its attendant corporate growth.

1/ New England Electric System, Eastern Utilities Associates, Boston Edison Company, Eastern Electric Energy System, Order Denying Application; Findings and Opinion of the Commission; Docket No. 70-4663, File No. 3-1698 (February 4, 1975) Holding Company Act Release No. 18801.

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Obviously, if PUHCA were repealed the EES affiliation could have been consummated without SEC scrutiny and the public interest could, thereby, have suffered owing to the absence of any other agency fully prepared to deal with holding company mergers. More importantly, if PUHCA were repealed an important regulatory barrier to inefficient mergers would be eliminated. Given the importance of the electric and natural gas industries to this country, it is apparent that repeal of the Act would be detrimental to the public interest on this basis alone.

Another merger proceeding which demonstrates the continued importance of the Act is the acquisition by the American Electric Power Company ("AEP") of the Columbus and Southern Ohio Electric Company. As you are aware AEP is the largest electric utility in the industry. The Antitrust Division of the Department of Justice and the SEC Staff opposed the merger on the grounds that it would violate the policies of the antitrust laws which are embraced by the public interest standards of PUHCA. The Ohio Municipal Electric Association intervened in the proceeding as well and asserted that the merger would adversely effect competition in the bulk power market in Ohio and thereby supported both the Antitrust Division and the SEC Staff.

This proceeding was unique because it attracted the participation of several investor-owned utilities which stood to be damaged by approval of the merger. The damage which was feared would arise from the termination of Columbus and Southern Ohio's participation in a regional power pool and the resultant loss of economies of scale.

The record of this merger proceeding benefited from a thorough investigation of AEP's prior acquisitions and acquisition policies. That investigation and the documentary evidence which was produced speaks for itself regarding AEP's past acquisition programs.

This proceeding was ultimately terminated by a negotiated settlement. The broad settlement reached severally between AEP and the Ohio municipals, and Ohio cooperatives, became a condition of the acquisition order and has lead to mutually beneficial power supply and transmission arrangements along with what generally appears to be good business relationships which augur well for the future. This is a very positive result of SEC's enforcement of the Act. The other Ohio investor-owned utilities, to the extent the level of their participation in the proceeding did not produce all the conditions necessary to protect them from future forced acquisition activity, can look to the proceeding as precedent for future protection.

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The case illustrates the importance of preserving the protections of the Act for programs of the large registered holding company systems which, by exercise of their dominant regional power supply, transmission, and pooling positions, are able by coercion in power supply matters and/or the availability of financial power to induce or force the acquisition of neighboring systems, whether they be investor, municipal or cooperatively owned.

The final merger matter which I believe is relevant to the pending legislation is the proceeding by which Northeast Utilities was created. This merger involved the consolidation of two Connecticut and two Massachusetts electric utilities and, owing to the multistate character of the merger, could not have been accomplished under state law.

While this merger was promptly approved, the importance of the SEC's actions under PUHCA lies in the fact that the consolidation of the four utilities was conditioned upon Northeast Utility's assurance of a high voltage interconnection between one of its operating companies and the City of Holyoke Gas and Electric Deparment ("Holyoke"), which was an intervenor in this merger proceeding. The SEC also ordered Northeast Utilities to give Holyoke access to the Connecticut Valley Electric Exchange ("CONVEX"). Previously, Holyoke was isolated electrically and subject to the continued take-over efforts of the Holyoke Water Power Company. Since the merger, interconnection and entry into CONVEX, Holyoke has enjoyed excellent financial health, the take-over effort has ceased, and Northwest Utilities has benefited business-wise from its transactions with Holyoke. Further, Holyoke's success in breaking into the CONVEX pool was a major milestone to the development of the New England Power Pool to which all New England electric utilities have reasonably fair access, whether large or small, or investor, muncipalically or cooperatively owned. I believe that this proceeding illustrates that the beneficial results of SEC enforcement of PUHCA are not always visable.

COMBINATION GAS AND ELECTRIC SYSTEMS

The SEC and the Courts have construed Section 11 of the Act to prohibit combination electric and natural gas utility holding companies because it was concluded that Congress wished to promote competition between gas and

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electric utilities as a means of improving utility service and minimizing utility rates. 1/ The continued vitality of the Act is demonstrated by this statutory prohibition against combination utility holding companies. History taught the Congress that such combined operations were detrimental to the public interest and repeal of the Act should not occur without a careful analysis of the potentially damaging effects of suspending this important feature of the PUHCA.

BULK POWER MONOPOLIES

As is evident from the discussion above, PUHCA is a quasi-antitrust statute which was enacted in response to the abuses of the very large utility trusts which grew up over the years. By the enactment of PUHCA Congress successfully sought to deter the recreation of large holding companies which exercised monopoly power over essential utility resources, such as large generating units which yield economies of scale. A good example of Congress' success in this endeavor is provided by Municipal Electric Association of Massachusetts v. SEC, 413 F.2d 1052 (D.C. Cir. 1969). This litigation involved the efforts by all or virtually all of the investor-owned utilities of New England to retain for themselves the benefits of atomic generating resources. More particularly, the New England investor-owned utilities sought to create new holding companies for the purpose of the exclusive development of atomic generating resources in the region. Under their proposals, only the investor-owned utilities would have the opportunity to purchase interests in the new entities and thereby the investor-owned utilities would retain control over this low-cost generation. The Court ruled that PUHCA would require open access to the generating companies, if the complaining Massachusetts municipal electric systems showed that excess concentration and control would result from exclusive ownership by the investor-owned utilities.

On remand, a relatively short but thorough investigation motivated the investor-owned utilities to offer all utilities in the New England region the right to purchase ownership interests in the atomic generating units. Further, another effect of this proceeding was to lay the foundation for regional power pooling and the benefits of the New England Power Pool may, in part, be attributed to the enforcement of the Holding Company Act in this proceeding.

1/ SEC v. New England Electric System, 384 U.S. 176 (1966) and Philadelphia Co. v. SEC, 177 F.2d 720 (D.C. Cir. 1949).

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The importance of Municipal Electric Association of Massachusetts and PUHCA cannot be overstated. In the absence of PUHCA, a monopoly over bulk power resources would have evolved, and power pooling advancements would have been lost. In the future, similar attempts to preserve for the few the benefits of innovation may well arise and if PUHCA is repealed the detrimental effects to the public interest would be profound.

REGIONAL POWER POOLING AND OPERATING EFFICIENCIES

Apart from its antitrust features, the Holding Company Act was intended to promote efficient utility operations and regulation. Congress had found that many utility holding companies were inefficiently operated and the integration standards of Section 11 were enacted with a view of requiring those holding companies which survived to operate in a coordinated and efficient manner. Another objective was to ensure that those holding companies which survived would be adequately regulated, it having been determined that existing federal and state regulation were inadequate to control holding companies.

It might be assumed that these efficiency criteria are not of current importance. However, recent proceedings before the SEC concerning the Central and South West Corporation ("CS&W") and Texas Utilities Corporation ("TU") illustrate the continued importance of these features of the Act. Thus, certain municipal customers of a C&SW subsidiary complained to the SEC that the electric rates paid by all southwestern consumers were artificially and substantially inflated because C&SW, TU and the remaining Texas utilities operated in isolation from the remainder of the United States to avoid federal rate regulation. The complaining municipal customers asserted that C&SW contributed to this situation because its Texas subsidiaries were operated in isolation from its remaining two subsidiaries and that such conduct constituted a violation of the integration requirements of Section 11 of the Act. These same municipal systems alleged that TU was a primary cause of the situation and urged that its exemption from the Act be revoked.

These same parties estimated that the additional cost to all southwest consumers of isolating Texas from the United States cost southwestern consumers $100,000,000 per year.

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The SEC instituted proceedings and in response thereto C&SW conducted studies to test the accuracy of the assertions that its non-integrated status inflated rates substantially. C&SW's studies showed that substantial operating economies would be achieved if C&SW, TU and the remaining southwestern utilities were operated in the fashion required by PUHCA. This important matter generated litigation at the Federal Energy Regulatory Commission, the Nuclear Regulatory Commission and the Federal Courts. Ultimately, the matter was terminated by a negotiated settlement under which all the interconnected Texas systems will be connected to the South West Power Pool through two substantial DC (direct current) interconnections and all utilities will have the opportunity to use these facilities for major power supply transactions. The ultimate goal of the DC lines is to realize the reduction of utility rates which C&SW found would result from greater coordination of its affiliates' operations with all other continguous utilities. While the remaining regulatory problems will be dealt with by FERC and the state regulatory agencies, the fact is that only the force of the Act, as administered by the SEC, was sufficient to connect Texas with the rest of the Union.

EXEMPT HOLDING COMPANIES

The continued existence of PUHCA has a profound effect upon exempt holding companies. Thus, certain exemptions of utility holding companies are not permanent and the SEC is free to revoke any such temporary exemption if the circumstances which existed at the time the exemption was granted have changed. The possibility that an exemption will be revoked acts as a deterrent to abuses by exempt holding companies and the importance of this feature of the Act is substantial when one considers that there are more than 100 exempt holding companies, each of which are indirectly regulated by the shadow of the Act.

A pending proceeding before the SEC concerning an exempt holding company's abuses illustrates the continuing importance of the Act. The Aluminum Company of America ("ALCOA") is an exempt holding company and operates two subsidiary electric utilities. The first subsidiary is denominated as Nantahala Power & Light Company ("Nantahala") while the second is called Tapoca Electric Company ("Tapoca"). In the operation and management of the two subsidiaries Alcoa has allocated all of the low cost generating resources to Tapoca to the exclusion of Nantahala. Tapoca in turn sells this low cost power on a virtually exclusive basis to Alcoa for use in its smelting plants.

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Nantahala is thereby left with comparatively high cost power resources to serve its retail and wholesale customers. The wholesale customer, which is the Town of Highlands, North Carolina, the Attorney General of North Carolina and others have complained to the SEC requesting that Alcoa's exemption under the Act be revoked and that its public utility subsidiaries be operated in a fashion consistent with their public service obligations or be ordered to divest these utility companies.

The actions at the SEC were occasioned as well by the Supreme Court of North Carolina's ruling that consolidation of the two subsidiaries was required for rate-making purposes and its affirmance of a North Carolina Utility Commission determination that refunds of $18 million are due Nantahala's retail customers, owing to the allocation of high cost generation resources to the North Carolina retail customers. Nantahala has sought to oppose its retail refund obligation on the grounds that it does not separate have the funds to make good on its obligation and that payment of such refunds will compromise its ability to serve its existing customers. Of course, Nantahala is short of funds because its parent Alcoa won't provide the money or rearrange the intra-holding company agreement. In short, Nantahala is asserting that the State Commission should ignore its affiliation with Alcoa.

Nantahala's response to its state refund obligation and the continuing attempt to retain the benefits of low cost generation for Alcoa's shareholders through the manipulation of corporate shells illustrates the continued need for PUHCA. Only the Act empowers an appropriate regulatory body to see through corporate veils of this type.

This illustrates a development likely to occur in many cases in the future if the Act is repealed. ALCOA's exemption was obtained many years ago before the growth of load and the vast increase in fuel costs created critical problems. The unreviewed creation of subsidiary companies controlling public utility companies could lead to a proliferation of separate subsidiaries organized for the exclusive benefit of a few corporate interests, limited only by the ingenuity of counsel and consultants. As the ALCOA case illustrates, even effective State regulation cannot cope with holding company problems, and establishes the continued need for the Act.

Mergers and acquisitions in the corporate world, outside of regulated utilities, have become a hectic dog-eat-dog fray with a growing concentration of corporate power based upon financial leverage rather than economic

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justification. It has sponsored a large industry of investment advisors and underwriters, attorneys, consultants, accountants and the like who earn substantial sums from on-going corporate battles. Attached is a recent article from the Wall Street Journal recounting the activities of First Boston Corporation in participating in the "merger mania". We do not think it in the public interest that such merger mania be allowed to engulf the public utility industry. If the Act is repealed, huge profits will be made by merger operators and their advisors and brokers. Those profits will be siphoned off ultimately from the consumer, and those sums will be pocketed, irrespective of whether the resulting jerry-built corporate utility operation turns out to be economically sound and beneficial to the public utility consumer. In short the utility business is imbued with the public interest. The recent holding company abuses described herein demonstrate the continued need for PUHCA and I would strongly recommend that this needed statute be permitted to stand and continue to protect the public interest.

Moreover, the growth of the merger and acquisition movement has led to the takeover of public utilities, including exempt holding companies. Such take-overs and the resultant dangers to the public interest create the need for remedial legislation. Thus, in 1980 the Continental Group, a major multinational conglomerate, acquired Florida Gas Company. Florida Gas Company owned extensive retail gas distribution properties as well as Florida Gas Transmission Company, the sole gas transmission line in peninsula Florida, and Florida Gas Exploration Company, a gas and oil exploration and production subsidiary. The Continental Group, a large gas user, thereby obtained control of the major gas supplier to peninsula Florida (Flordia Gas Transmission). While Florida Gas Transmission is subject to regulation by the Federal Energy Regulatory Commission, the danger exists that this entity will be primarily concerned with the Continental Group's interests, as distinguished from the broad public interest.

This acquisition was accomplished without any regulatory review because the Florida Public Service Commission and the Federal Energy Regulatory Commission disclaimed any authority to review the matter.

Further, owing to the fact that Florida Gas Company sold its retail distribution properties prior to its merger with the Continental Group the groundwork was laid to avoid SEC regulation under the Act. Such groundwork was extended by Continental's reliance on a SEC rule promulgated under PUHCA which provides that natural gas pipeline companies are not "retail gas companies", even though such entities sell large quantities of gas at retail. As a result of this Rule, Continental's acquisition of Florida Gas was exempt from the Act and no SEC scrutiny was applied to this transaction.

I would strongly suggest that Congress consider closing this loop hole in the regulatory framework and amend the Act to encompass the ownership of interstate pipeline companies generally as subjecting a holding company systems to jurisdiction under the Act.

Very truly yours,

George Spiegel

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Artful Adviser

How First Boston Corp. Turned Itself Around Amid a Merger Mania

Acquisition Unit's Directors; Using Creative Synergy, Improved on a Two-Step

The 1982 Model of Takeovers

By Tim Metz
Staff Reporter of The Wall Street Journal

NEW YORK—In the fall of 1977, about 100 investment bankers at First Boston Corp. gathered in suburban Tarrytown, N.Y., for a day of sobering self scrutiny.

The once-dominant Wall Street firm's earnings were in a two-year slide. The discouraging results of a private study were read, showing that First Boston's reputation had slipped in segment after segment of the investment banking business.

The talk finally turned to the firm's fledgling mergers and acquisitions division. Peals of derisive laughter greeted the news that corporate officials sampled in the study considered First Boston "no factor at all" in the business. "We were *off* the chart," concedes Bruce Wasserstein, a co-director of the M&A division.

Today, that laughter has a hollow ring. Last year, First Boston's M&A specialists helped orchestrate the two costliest corporate takeovers in history: Du Pont Co.'s record $8.02 billion acquisition of Conoco Inc. and Marathon Oil Co.'s merger with U.S. Steel Corp., valued at over $6 billion.

An Apparent Record in Fees

All told last year, the firm was involved in $32 billion of completed or announced mergers, earning over $75 million in fees—both believed to be Wall Street records. Last year's fees "were triple those in 1980, which in turn were double those in 1979," adds Joseph R. Perella, the M&A unit's other director. Not coincidentally, First Boston recently reported its third consecutive year of record earnings and just yesterday reported its third consecutive record first quarter (see story on page 41).

That the First Boston unit was able to spring so nimbly ahead of the pack attests to a curiously effective personal synergy between Messrs. Perella and Wasserstein and to their controversial refinement of strategies that allow the hungriest—but not necessarily the richest—suitor to win a contested takeover battle.

With their help, client Pullman Inc. in 1980 avoided the clutches of McDermott Inc. in favor of a merger with Wheelabrator-Frye Inc. Similarly, St. Joe Minerals Corp. rebuffed Seagram Co. in favor of a match with Fluor Corp. The firm also handled last year's $2.5 billion acquisition of client Santa Fe International Corp. by Kuwait Petroleum Corp.

Year's Activity

Merger activity through the first two months of this year was even higher than a year before. W.T. Grimm & Co., a Chicago-based merger broker that keeps detailed statistics, says that January-February merger announcements totaled 390, up from 367 a year before, and transactions over $100 million doubled to 18. But "many of the large transactions this year were divestitures, not situations involving change of corporate control," says Tomislava Simic, Grimm's research director.

Thus, while several Wall Street firms, including First Boston as well as competitors Goldman, Sachs & Co. and Merrill Lynch & Co., had higher first quarter mergers and acquisitions fees than a year ago, there have been precious few of the heart-stopping corporate attacks of 1981.

Some Wall Streeters say that may be changing. Arthur F. Long, the president of D.F. King & Co., says his company is accumulating stocks of eight target companies for King clients just now, and two offers in the $100 million to $500 million range "should pop in the next few days."

Smaller Mergers

Nobody however, expects 1982 to match last year's record $82.6 billion of takeovers, partly because most . . . the mergers are smaller. American General Corp.'s recent plan to take over NLT Corp., another insurer, was the year's first proposal to exceed $1 billion. And, like most acquisitions this year, payment is to be in stock, not cash.

As one takeover lawyer puts it, "A chief executive who goes before his board these days for permission to borrow $5 billion or $6 billion for a deal is asking to be lynched. With interest rates at around 16% and inflation only 2% to 3%, the real cost of borrowing is sickening."

Takeover advisers, nevertheless, expect the merger pace to quicken as corporate predators try to act before an expected stock market rally bolsters the price of their prey. First Boston, for one, has added five professionals to its mergers group this year, for a 16% expansion.

Although few would dispute First Boston's prowess as a corporate matchmaker, some question the suitability of the unions it arranges. To detractors, First Boston's techniques amount to a violation of natural law, sometimes allowing less-than-fit companies to emerge victorious and spawning corporate havoc in the process.

"Bruce Wasserstein is a genius," says the top mergers professional at a competing firm, "but when I see some of the companies he has put together, I wonder if he has even a shred of common sense."

Messrs. Wasserstein and Perella share in running the 36 member M&A unit at First Boston, are paid equally (in seven figures, after last year's record results), and occupy identically sized corner offices on the 42nd floor of First Boston's midtown skyscraper headquarters.

There, however, all similarity ends. 34 year-old Mr. Wasserstein's greatest

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strength is as a highly inventive tactician. Plumpish, of average height and with a shock of tousled red hair, he is widely regarded as possessing a dazzling intellect and a healthy — some say overweening — ego. "There was never any question in Bruce's mind *that* he'd be a success, only *where*," says a First Boston insider.

What Did He Say?

At meetings with colleagues and clients, he spews forth takeover strategy with intimidating precision and speed. An admiring competitor says: "He scares the hell out of some directors when they realize they've been listening to him for half an hour and they still don't understand a single thing he's said."

Garrulous, ebullient and impeccably dressed, Mr. Perella has an unpretentious manner that is the perfect foil for Mr. Wasserstein's intensity. The son of an Italian immigrant, the 40-year-old Mr. Perella is expert at smoothing over his co-director's rough edges, both inside and outside the firm. "Wasserstein is best at figuring out what a client should do, and Perella is best at getting the client to do it," says a takeover professional who has watched the two work.

Mr. Wasserstein, with unabashed immodesty, has his own explanation of their contrasting strengths: "If the (client) company is run by a 65-year-old self-made type who doesn't want to have people telling him what to do, he's usually more comfortable dealing with Joe. If he's a 45-year-old boy-genius type, he may be more comfortable with *me*."

First Boston didn't invent the "two-step" takeover strategy it has employed to such obvious advantage; it has been used for years to help would-be acquirers conserve cash. Typically, the first step of the strategy involves a cash tender offer for about half the target company's stock. The remaining shares are acquired in a second step, in exchange for the acquiring company's stock or other securities.

Mr. Wasserstein has concocted an all-important refinement to this ploy that First Boston has used on behalf of an acquiring company or to help a target company's favored suitor win a bidding war. Fiendishly simple, the tactic involves making the initial cash tender offer worth more to target-company shareholders than the second-step merger. This, in turn, creates a stampede by shareholders to tender their shares in order to avoid the lower payoff promised in the later merger. Obviously approval of the merger is thus nearly ensured, because the acquiring company has control of half the target's shares and votes them in favor of the merger.

First Boston has pioneered a second ploy to flush out a bid from a friendly suitor and make a takeover too risky for all but that company. Known as lock-up options, these are attractively priced, firm options on a key asset or stock granted by the target company to the preferred suitor.

Thus, to induce U.S. Steel to top Mobil Oil Corp.'s bid for First Boston client Marathon Oil, the steelmaker was granted a pair of such options. One would have allowed U.S. Steel to buy Marathon's "crown jewel" asset, its nearly 50% interest in the rich Yates oilfield in Texas, for $2.8 billion. Another would have let U.S. Steel acquire 10 million newly issued Marathon shares at $90 each.

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[illegible] challenged the options and man aged to convince a Cincinnati federal ap peals court panel that they were illegal Mobil's victory was hollow, however, be cause it wasn't able to get an antitrust in junction lifted so it could buy Marathon stock.) Yet First Boston was seemingly vin dicated in a more recent New York federal court decision that held such options aren't illegal.

Marathon's shareholders approved the acquisition by U.S. Steel last month after the fizzling of a threatened shareholder revolt over the two-step takeover strategy exe cuted by First Boston. The Marathon hold ers [illegible] at the difference between the value of the U.S. steel notes (around $78) ex changed for Marathon stock under the second-step merger and the $125 in cash paid for each Marathon share in the earlier tender offer.

Eventually, given Marathon holders real ized that even the $78 U.S. Steel notes were preferable to the value of $40 to $50 per share that most analysts predicted for Mar athon stock should the merger fall through.

[illegible] departures haven't been uncommon

GAF Reopens Plants As Construction Pace Revives in Some Areas

By a WALL STREET JOURNAL Staff Reporter

NEW YORK – GAF Corp., which had been forced to lay off about two thirds of its [illegible] building materials division workers, said it began to reopen plants in response to [illegible] demand by the construction indus try.

The division reopened facilities in Fon [illegible], Calif. and Mt. Vernon, Ind., employing [illegible] and [illegible] workers, respectively. The com pany said it plans to reopen six additional plants by the end of May, which would bring about half the division's workers back on the job.

The six plants scheduled to reopen in the next few weeks are Erie, Pa., with 78 em ployes; [illegible], Mass., 77; Minneapolis, 102; [illegible], Ala., [illegible]; Savannah, Ga., 200, and [illegible], 79.

[illegible] the company said it still couldn't say when a number of other building materials plants would reopen. They include Joliet, [illegible]; [illegible] Gloucester, N.J., 144; Chester, S.C., [illegible]; [illegible], 98. GAF hasn't any firm plans for reopening plants in Denver and Kansas City.

A GAF spokesman said demand for building materials was picking up primar ily in the Northeast and Southeast, sparked by warmer weather. He didn't suggest that the construction industry, which has been [illegible] by the current recession, is staging a recovery. "Mostly, it's a factor of weather," he said.

In addition, the spokesman said that there have been [illegible] inquiries by possi ble buyers for GAF's building materials di vision. In March, the company said two con cerns, neither of them identified, had ex pressed interest in acquiring the division.

in First Boston deals. Fluor, for example, paid $60 cash per share for nearly half of St. Joe Minerals' stock in its tender offer, but exchanged Fluor stock then worth only $44.55 for each remaining St. Joe share in the second step merger. There were howls, too, from Conoco shareholders when First Boston client Du Pont outpointed Seagram and Mobil last year in the battle for Conoco. Du Pont paid $98 cash for each Conoco share in its tender offer, but exchanged only $64.81 of its stock for each Conoco share in the ensuing merger.

First Boston has some legal support for its two-step ploys. In a recent challenge by Marathon shareholders over U.S. Steel's second step price, Ohio federal Judge Carl B. Rubin ruled that "both the case law as well as the Securities and Exchange Com mission rules and regulations appear to con template" disparate two-step pricing ar rangements.

Principals in some First Boston transac tions may be in for problems, observers say.

Du Pont, critics charge, may itself have been ill advised to listen to First Boston. Seagram, though it finished behind Du Pont in the bidding for Conoco, purchased enough Conoco shares to eventually swap them for 20% of Du Pont stock – giving it perilously close to working control. Further, fears of dilution raised by Du Pont's issuance of shares to buy Conoco helped send Du Pont's stock tumbling. Selling at over $50 before it went after Conoco, Du Pont shares closed yesterday at $34.75.

At Pullman, employes – rather than shareholders – appear to be the principal los ers in the aftermath of Pullman's merger with Wheelabrator Frye. Wheelabrator took on so much debt in buying Pullman that its long term debt to capital ratio rose to a dan gerously high 50%.

Moving quickly to drive down that debt, Wheelabrator gave more than 1,500 Pullman employes their walking papers. In addition, Wheelabrator has sold five Pullman divi sions and has spun off a 50% equity in the Chicago company's core rail freight car business. Wheelabrator's debt to capital ra tio has declined to 22%, "but they've had to tear Pullman to pieces in the process," says a first Boston competitor.

Sour Grapes?

Messrs. Perella and Wasserstein sniff sour grapes in such criticism. "You judge an investment banker on the sell side by whether he finds a white knight and gets an attractive price for the target's sharehold ers," Mr. Perella says. "That's precisely what we did in Pullman." And with St. Joe, says Mr. Wasserstein, the alternative to Fluor was a Seagram unwilling to pay more than $45 a share.

On the buy side, Mr. Perella says, the test is "whether the client pays too much." Noting that when Du Pont acquired Conoco it bought oil in the ground worth about $8 a barrel for $2.75 a barrel, he says, "we'll stand on that performance any day." As for Du Pont's depressed stock, Mr. Perella ob serves that Dow Chemical Co. is selling at an even deeper discount and "Dow didn't buy an oil company."

The swirl of controversy hasn't damp ened demand for the M&A unit's services. Its growing workload means that Messrs. Perella and Wasserstein don't often work in tandem on projects as they once did. But by dint of their contrasting styles and back grounds, they are still viewed as a highly ef fective team, both inside and outside the firm.

An accountant by training, Mr. Perella began his career by counting municipal bonds in the third subbasement of a Wall Street brokerage firm for $6,500 a year. He fled, at age 28, to Harvard Business School, where for the first year he lived off savings. (His father, who had just lost his job as a corporate economist in the aftermath of a takeover, was unable to help pay his tui tion.) In his second year, he won a scholar ship from Goldman, Sachs & Co., a prime First Boston competitor. "Even though they paid for half of my M.B.A. degree, Goldman didn't offer me a job," Mr. Perella chortles.

Seeing opportunity in First Boston's dearth of Harvard M.B.A.s (only 10 at the time) and attracted by the apparent lack of vicious office politics ("they play with rub ber knives here"), Mr. Perella signed on as an $18,000 a year associate investment banker in 1972. A year later, he took a newly created job as the firm's M&A specialist af ter, he says, "they told me I was too old for a regular career path here."

Wasserstein's Background

It was Mr. Perella who recruited Mr. Wasserstein in 1977. The son of a wealthy New York textile manufacturer and real es tate investor, Mr. Wasserstein – by age 24 – had earned M.B.A. and law degrees from Harvard and a postgraduate degree in eco nomics from Cambridge University, and was then working as a Wall Street lawyer handling takeovers. Two years later, Mr. Perella proposed that Mr. Wasserstein be el evated to co-director of the M&A division.

Mr. Perella confesses that the strain of his profession has at times caused him to suffer from chronic back pain and, at one point, a dragging foot. Once he even left a business meeting at 2 a.m. to visit his Japa nese acupuncturist.

Mr. Wasserstein, by contrast, seems to thrive on tension. "I'm one of those people who need a crisis to be at my best," he says. Dreaming up takeover strategy, he adds, "is like playing chess where the rules change after every move."

The two men have pursued an intention ally unorthodox course in staffing their M&A shop. Rather than the customary platoon of Harvard M.B.A.s, they have sought out what Mr. Perella terms the "hybrid vigor" of an ethnically and socially diverse group of pro fessionals.

For example, William Lambert, who re cently was named the third ranking execu tive in the department, "barely graduated" from Ohio State University, though he later earned an M.B.A. from Columbia and a solid reputation as a securities analyst. The 35-year-old Mr. Lambert – profusely bearded, often tieless and even beltless, and with fondness for delicatessen lunches at his desk – hardly fits the investment banker mold. But he is so highly regarded by Mr. Perella that the latter recently grew a beard in an effort to ease First Boston managing direc tors' qualms about elevating Mr. Lambert to their own ranks.

Mr. Perella didn't always carry such weight around the firm. He toiled in virtual peonage through the mid 1970s, working in a field for which First Boston had little appe tite. The firm had been stung by its involve-

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ment during the late 1960s, in the messy and litigious Chris-Craft Industries Bangor Punta Corp. takeover squabble over Piper Aircraft Corp.

First Boston's Role

First Boston had handled Bangor Punta's successful rescue of Piper from the unfriendly Chris-Craft bid. Chris-Craft wound up suing all parties involved. First Boston—its pockets deeper than the other defendants'—faced the prospect of anteing up most of a $38 million federal-court damage award, until it was finally overturned by the Supreme Court in 1975. Mr. Perella, noting that $38 million represented about half of First Boston's total capital at that time, explains: "All this had come about as a result of our taking on an assignment where we earned a fee of well under $100,000. That's why M&A was a dirty word around here in the early 1970s."

In 1975, the guard changed at First Boston. George Shinn, the current chairman, took the reins and began pushing to turn the firm from a clubby aristocracy into a meritocracy. (When he joined the firm in 1977, Mr. Wasserstein was only the second Jew among the 100 or so corporate finance professionals on the staff, though many others have since been hired.)

Shortly after their humiliation at the Tarrytown meeting, Messrs. Perella and Wasserstein began pressing the firm's top management to commit the resources to allow them to expand the M&A unit. As their proposal was being weighed, manna—in the form of two fat merger jobs—fell from heaven. First Boston represented Kennecott Corp. in its acquisition of Carborundum Co. and Combustion Engineering Inc. in its acquisition of Vetco Inc. The two deals yielded $3 million of fees in a single month: November 1977.

Good Luck

Landing Kennecott was pure good fortune. The big copper concern had been dropped as a client by Morgan Stanley Co. after it became apparent that Kennecott was the logical candidate to rescue Carborundum — another Morgan client — from a hostile bid by Eaton Corp.

Smelling profit in the mergers business, First Boston management approved the plan that Messrs. Perella and Wasserstein had been pushing for: an expansion, in 1978, of the unit to 18 professionals from only four the year before. With added manpower, the firm was able to specialize in new areas and aggressively solicit new business—culminating in last year's pair of history making mergers. Over two-thirds of First Boston's M&A clients last year were new to the firm.

For all their newfound success, First Boston insiders keep a watchful eye on archrival Morgan Stanley, where the M&A department is triple the size of First Boston's. Morgan Stanley is watching First Boston, too. A recent full-page newspaper ad by First Boston proclaiming its record M&A year sent Morgan operatives scurrying to their computers to search for higher figures. None have materialized, though Morgan officials refuse to concede defeat. One Morgan insider allows only that "First Boston has had a grand year. They've come from nowhere—to No. 2."

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Mr. SWIFT. Thank you very much, Mr. Richardson.
Mr. Smith.

STATEMENT OF S. KINNIE SMITH, JR.

Mr. SMITH. Good morning, Mr. Chairman.

I am here today to represent the American Gas Association. I am Kinnie Smith, general counsel of American Natural Resources Company of Detroit. At one time we were a registered holding company. We became an exempt holding company for a period of years and we are now completely free from the act.

The American Gas Association is an association of approximately 300 gas utility distribution companies and pipeline companies. Amongst our members are three registered holding companies, approximately 60 exempt holding companies, and the balance include a number of companies who seek to restructure themselves as a holding company, if they were free or were to be free of the act.

The industry is extremely interested in this legislation. I should advise you at this time in response to a letter of May 10 from the chairman of your subcommittee to the association that this issue was presented to the AGA board of directors, and that the board by a substantial majority recommended repeal of the act. There are members who felt differently and presumably they would prefer an amendment of one sort or another. We would expect that they would present their views individually to your committee and to the other side, and in the halls of Congress, as appropriate.

We have already submitted a summary of my statement. The statement of Mr. Nichols and of Mr. Collins and Representative Corcoran duplicate the basic points which we feel call for outright repeal of this act. As a consequence, I would like to use my few minutes to highlight just two or three subpoints, particularly, first, the issue of allocation of common costs, and the control of affiliated transactions. It was mentioned by Chairman Ottinger in his opening remarks.

We feel very strongly that with the development of regulations by the State public service commissions, with the adoption of the uniform system of accounts, and with the aggressive and vigorous rate proceedings which include detailed audits, this is simply not an issue that affects the broad question of whether the Public Utility Holding Company Act should be repealed. I can speak from our own experience.

We have, as a holding company system, faced common issues every year in the rate cases as to how costs should be allocated between the various businesses in which we are engaged. The Federal Energy Regulatory Commission has for years regulated pipeline companies which have been extensively diversified. It is able to allocate costs and can audit these costs.

If the State commission or a Federal commission like the FERC is dissatisfied with the way the costs are allocated, they can insist on additional procedures. If they want the officers to keep time reports they can keep time reports. They can go down to any extent of detail on a public utility to allocate these costs and to determine a fair cost for intercompany transactions. I really think it is an extraneous issue to the issue of repeal of the act, and I feel very

strongly on that. I think that my company's experience and the experience of the industry will demonstrate that.

Second, it has been mentioned before that the Holding Company Act imposes severe restrictions on the ability of registered companies to finance. Since it limits their flexibility, the advance-approval requirement is a requirement that certain terms of securities be used does seriously affect their ability to obtain financing on the best terms in the current markets. Markets are fluctuating not only in terms of interest rates, but also the terms of the securities themselves will change literally from day to day.

A company may need to extend or shorten its maturities, change its sinking fund, change other retirement provisions, adopt conversion provisions, such as conversions into debt and equity securities. All of these have traditionally caused problems under the Holding Company Act, but it is the need to respond to these markets quickly, literally overnight, so as to get the lowest cost of capital which will benefit not only the stockholders but also the ratepayers.

Turning now just briefly to diversification: From the standpoint of the registered holding company, in addition to being limited to functionally related activities, which is a problem for these companies in planning their long-term growth and their desire to diversify, there is a procedural problem with the act, which would apply in the case of an acquisition even if it was a functionally related business.

A registered company must go to the Commission for its approval. This requires the submission not only of your contracts but the data which economically supports and justifies this action. This gives you two problems. One, if there is any competition in this acquisition, is faced with an uncertainty: Will the Commission approve it? Will there be unreasonable delays?

Second, it opens up the buyer, that is the registered holding company, to competition who can come in, examine the file, perhaps call for a hearing and then step in and take the company out from under you with a slightly higher bid. It is a serious procedural problem for acquisitions by registered holding companies.

With respect to the exempt holding company, the principal problem of the act, of course, is the effect on diversification. They must comply with the clause of section 3A which applies a very broad and general standard of not being detrimental to the public interest or the interest of consumers and investors.

Now that is a very general standard, and there have only been two or three cases which give any guidelines, so what happens is that if you are going to make a significant entry into other businesses, and you are an exempt holding company, you are faced with the risk that this might step over the boundaries of the *Pacific Lighting* case and thereby put your company into a position where it would either have to divest of one or more of its diversified activities or lose its exemption.

Either one is a disaster from the standpoint of the board of directors. I feel this rather strongly personally because, during the period when we were an exempt holding company, every time an acquisition was proposed to the board, I was asked the same question. I should have made a tape recording, to try to describe these general standards and how they might be applied and to explain to

the board that there was no way that I could assure them as their counsel that this acquisition was safe in the long run, for fear that the Commission would at a later point, with hindsight, come in and say it was an imprudent acquisition which exceeded the standards of the *Pacific Lighting* case, thereby endangering our exemption, or forcing us to divest an operation which we did not wish to divest.

I would like to make one further point, which I overlooked with respect to the allocation of cost issue. Actually, I think a very strong argument can be made that holding company structures are better and easier to administer from the standpoint of allocation of costs. The gas distribution company, or electric distribution company can be put into a separate single entity, and its capital costs can be best abstracted, not that it can't be done in the other context, but it is more complicated, and it takes more sophisticated tools by the regulator. We feel that the holding company structure actually should benefit the State regulator in enforcing its rate regulations, securities regulations, and certificate regulations.

I probably have consumed my time. Thank you very much, Mr. Chairman.

[Testimony resumes on p. 485.]

[The prepared statement of Mr. Smith follows:]

TESTIMONY

OF

S. KINNIE SMITH, JR., GENERAL COUNSEL

OF AMERICAN NATURAL RESOURCES COMPANY

FOR THE

AMERICAN GAS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER

OF THE

COMMITTEE ON ENERGY AND COMMERCE

U.S. HOUSE OF REPRESENTATIVES

ON THE

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

June 9, 1982

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Introduction

I am S. Kinnie Smith, Jr., General Counsel of American Natural Resources Company. I also serve as Chairman of A.G.A.'s Task Force on Diversification and as Vice-Chairman of the A.G.A. Legal Section. I am accompanied by Richard Rosan, Special Consultant to the American Gas Association (A.G.A.), and by Andrea R. Hilliard, A.G.A.'s Manager and Counsel of Legislative and Regulatory Affairs.

The American Gas Association is a national trade association which represents nearly 300 natural gas distribution and transmission companies serving over 160 million consumers in all 50 states. Collectively, A.G.A. member companies account for nearly 85% of the nation's total gas utility sales annually.

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Natural gas currently provides about 27% of the energy consumed in the U.S. Gas is used in about 55% of all domestic residential and commercial establishments, and it provides 40% of the energy consumed by domestic industry, including agriculture. Almost all gas used in the U.S. is produced domestically, and natural gas provides two and one-half times as much end use energy to consumers as electricity. Thus, natural gas is a vital part of this country's fuel mix.

As the members of the Subcommittee know, there have been a number of bills before Congress in the past two years that proposed to deal with regulatory reform. As an industry that is probably the most comprehensively regulated of all indusry, both at the federal and state levels, the gas industry has actively considered and commented upon such legislation. Basically, most bills have been omnibus legislation equally applicable to all agencies. The gas industry's position has been that true regulatory reform requires examination by Congress of the statutory charters of each agency, the manner that such agency interprets its applicable charter, and the procedures of the agency thereunder. Only in this way can effective regulatory reform be achieved. Accordingly, we applaud this effort by Congress to review the Public Utility Holding Company Act of 1935 (the Act).[1/] We believe that the time has come to recognize that the economic, legal, and regulatory structures that existed in the late 1920s and early 1930s in support of the Act are no longer applicable. The Act, as administered by SEC during the twenty years after its passage,

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1/ 15 U.S.C. §79.

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corrected the unsound conditions that existed; since that time, the function of SEC has been mostly administrative housekeeping.

I am therefore most pleased to provide you with the gas industry's views on the proposed legislation.[2/]

A.G.A. member companies are affected in different ways by the Act. Three of our member companies[3/] remain registered under the Act. Well over 60 of our member companies are exempt holding companies under the Act. The remaining distribution member companies are not covered by the Act, although some would like to change to a holding company corporate structure but choose not to do so for fear of falling under the Act. Thus, A.G.A.'s testimony will focus upon repeal of the Act, as has been proposed in H.R. 5465 (Tauzin, D-LA) and H.R. 6134 (Collins, R-TX). I will discuss why total repeal of the Act is necessary and appropriate and what its impact on our industry will be.

Repeal of the Act and the Need for Meaningful Regulatory Reform

A.G.A. views the Act as one additional overlay of unnecessary federal regulation that is hampering the ability of the natural gas industry to take its proper place in providing a greater part of this nation's fuel mix. We view our support of repeal of the Act as part of our overall industry desire to streamline the regulatory process, thereby enhancing our ability to obtain adequate gas sup-

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2/ H.R. 5220 (Corcoran, R-IL) would amend the Act to benefit certain exempt holding companies by allowing them greater latitude in developing corporate strategies for diversification. H.R. 5465 (Tauzin, D-LA) and H.R. 6134 (Collins, R-TX) would repeal the Act in toto.

3/ Columbia Gas Systems, Inc., Consolidated Natural Gas Company and National Fuel Gas Company.

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plies and provide adequate utility service reliably and efficiently. A.G.A. has taken a strong role in encouraging Congress to adopt responsible regulatory reform legislation. We have also supported the Administration in its efforts to enforce its own initiative for regulatory reform through implementation of E.O. 12291.[4/] Finally, A.G.A. has taken an active role in previous and ongoing Congressional efforts to streamline the permit process for major energy facilities in the form of "fast track" licensing proposals such as contained in H.R. 3236 by Congressmen Morris Udall (D-AZ) and Manuel Lujan (R-NM).

Regulatory delays and uncertainties can hinder the ability of the gas industry to provide its proper share of the nation's future energy needs and to perform related system maintenance and construction. A recent A.G.A. study estimates that this industry must make a cumulative capital investment of $482 billion (in 1982 dollars) to provide this industry's share of energy through the year 2000[5/]. Much of this capital must be invested in exploration and development of new gas reserves and new supply sources, such as SNG and LNG. Overregulation at the federal and state levels will make it extremely difficult for this industry to attract the new capital necessary to meet these capital needs.

Many gas companies would like to move into exploration, production and other supply projects (e.g., coal gasification) or into marketing projects, such as jointly-owned user/utility cogenera-

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[4/] Executive Order No. 12291, 46 Fed. Reg. 13193 (February 19, 1981).

[5/] Energy Analysis: A Forecast of Capital Requirements of the U.S. Gas Utility Industry to the Year 2000: 1982 Update, American Gas Association, Arlington, Virginia (1982).

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tion facilities, low Btu on-site gasification facilities or natural gas-powered vehicles. Such diversification into gas utility related activities is important in order that these enterprises can show a satisfactory earnings growth and thereby maintain the financial strength so necessary for a capital intensive industry. This financial strength enhances the attraction of capital at lower costs. However, as we will discuss later in detail, the Act may impede or prevent registered and exempt holding companies from pursuing these kinds of needed corporate strategies. In addition, it will probably deter other gas utilities from adopting a holding company structure which may be essential for pursuing -- efficiently and profitably -- such activities.

Thus, repeal of the Act would provide important relief for the regulated natural gas industry. At a time when many voices are urging Congress and the Administration to eliminate unnecessary regulation and to streamline the regulatory process, the Act should be repealed since it places needless impediments in the operations of many gas companies. We emphasize needless impediments, because the gas consumer will be protected, both as to service and rates, after repeal of the Act. In other words, today the Act is not necessary to protect the consumer, the public, and the investor in their areas of critical interest.

The Act Should be Repealed

A. The Act is No Longer Needed

Congress passed the Act in 1935 at a time when many practices of public utility holding companies were detrimental to the interest of utility consumers and investors. Part of the current impetus for

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repealing the Act comes from the fact that the practices cited as justifying the Act in 1935 have been eliminated. The vast holding companies that existed in 1935 have been broken up, restructured and simplified as called for by the Act. Under the Securities Act of 1933 and the Securities Exchange Act of 1934,[6/] administered by the Securities and Exchange Commission (SEC), all companies with publicly issued securities, including holding companies, are required to disclose operating and financial data on their companies and subsidiaries using a uniform system of accounts. This now allows investment analysts and investors to make reasoned and informed investment decisions prior to investing in holding companies and their subsidiaries. The investor protections sought by the passage of the Act in 1935 have long since been obtained. Additionally, states presently regulate effectively the utility subsidiaries of holding companies. States have the power to investigate and control intercompany transactions, with the result that state commissions have adequate information and power to regulate proper charges to utilities by their parents or affiliates.

State utility regulation has been greatly enhanced by the adoption of a uniform system of accounts for all gas and electric utilities at both the federal and state levels. This assures that investment in plant facilities and all operating expenses are properly and uniformly recorded. Because of this important development, state commissions can effectively regulate utility rates, and investors and the general public have an accurate report of a company's operating results and balance sheet account.

6/ 1933 Act - 15 U.S.C. §79a. 1934 Act - 15 U.S.C. §79b.

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The Natural Gas Act of 1938[7/] assures that the activities of interstate gas pipelines are regulated closely. This fills a gap which, in 1935, hampered regulation of gas utilities.

All companies, including holding companies, with securities issued under the federal securities laws and listed on major stock exchanges, are subject to more stringent scrutiny by the investment community than was the case in 1935. In short, the Act has served its purpose of creating simplified corporate structures of holding companies; because of the comprehensive scrutiny of corporate practices by the investment community, the possibility of repetition of past bad practices is remote. Basically, the needs in 1935 to protect consumers of utility services and to give investors adequate information no longer exist. These needs are being effectively supplied by a number of new regulatory and constitutional strictures, so that the Act is primarily duplicative and unnecessary.

B. The Act is an Unnecessary and Costly Impediment

The Act applies to gas holding company systems with subsidiaries which sell natural gas at retail. There are two types of utility holding companies under the Act -- registered and exempt.[8/] The Act provides substantial impediments for both types of holding company systems.

7/ 15 U.S.C. §717.

8/ Registered holding companies are holding companies which, for a variety of reasons, have remained subject to the Act's stringent limitations. Exempt holding companies are those which have satisfied one of the five exemption criteria, such as being a predominately intrastate utility, provided under Section 3 of the Act.

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1. For registered holding companies, there are substantial limitations on their activities as well as on acquisitions of new companies. If a holding company desires to invest in new activities, it must obtain SEC approval of the activities. SEC is bound by the Act's restriction that there be a functional relationship between the company's utility activity and the proposed acquisition activity. In light of the many new technologies affecting the energy industry, this poses increasing difficulties both for SEC and the holding company. For example, is coal mining with possible future uses for coal gasification functionally related? Thus, the Act's substantive and procedural requirements can be applied to block new activities which can benefit the holding company and the economy as a whole.

Potential acquisitions by registered holding companies are limited by the Act. In addition to requiring that there be a functional relationship between the holding company's utility activities and the proposed acquisition, the Act's procedural requirements can severely hamper a registered utility's exploration and development efforts or other forms of supply acquisition activities. For example, if a registered holding company offers to acquire a drilling company (a proper functional activity for a gas utility system), the holding company must file an application with the SEC setting forth all the terms and conditions of the acquisition contract, including the economic justification for the transaction, and thereafter, such information must be published in the Federal Register.[9/] Approval cannot be granted until a specified waiting period has elapsed, and members of the general public can request

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9/ 17 C.F.R. 250.23(e).

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a public hearing that may delay SEC approval of the acquisition. This approval requirement places the registered holding company at a severe competitive disadvantage in competing with other potential buyers. First, the necessity for SEC approval and the time required to obtain such approval may dissuade the seller from entering into the contract. Second, public disclosure of the terms and conditions may permit other bidders for the drilling company to out-maneuver the holding company. This is an example of how a registered holding company seeking to secure adequate supplies for its consumers by moving into exploration and development activities can be thwarted by application of the Act.

Joint ventures are an important way of accumulating the capital necessary to construct major energy facilities, such as new pipeline systems, coal gasification or other highly capital-intensive supply projects. This will certainly increase if our industry realizes the $482 billion (1982 dollars) capital requirement to meet supply projections by the year 2000. Nevertheless, until recently, registered holding companies have had great difficulty in finding participants for joint ventures willing to run the risk of being considered by the SEC as being covered by the Act merely by virtue of their joint participation with a registered holding company. In 1980, the SEC adopted Rule 16,[10/] which prevents joint participants from being drawn into the Act so long as the registered holding company owns no more than 50% of the joint venture. Nevertheless, the Act has served and continues to serve as a deterrent to joint ventures. In some cases, millions or even

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[10/] 17 C.F.R. 250.16.

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hundreds of millions of dollars in years of planning and engineering are required before a new major gas supply project can reach the stages when final negotiations for financing and financial documentation can be consumated. If the project is a joint venture which includes a registered holding company as a participant, this time and money will be spent with a major uncertainty, that is, whether the holding company's equity or other fnancial participation will be approved by the SEC under the Act. Thus, while Rule 16 may exempt the joint venture entity and its financing from SEC approval, the joint venture will still be subject to the risk that one of its members may face difficulty and delay in obtaining necessary regulatory approvals to finance such member's participation in the joint venture. Because of the detailed nature of the SEC's financial regulation under the Act, these approvals cannot be anticipated by early filings and thus, as a practical matter, can only be sought in the final stages of the long preconstruction period of any major energy project.

Aside from some of these substantive obstacles posed by the Act, there are innumerable duplicative and unnecessary reporting requirements and applications that are time-consuming and costly. For example, all companies with securities which are publicly traded must file with the SEC annually a 10K report. A registered holding company must file a U5S report annually with the SEC. The U5S is quite voluminous and largely duplicative of the 10K report. Eventually, the consumer must bear the cost of this paperwork.

A registered holding company is subject to certain restrictions on security transactions (including loan guarantees) between the public utility, its parent and sister subsidiaries. The issuance

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or acquisition of a registered holding company's own securities or those of its public utility subsidiaries, even if not offered to the public, cannot be accomplished without filing for and receiving SEC approval under both the 1933 and the 1935 Acts.

2. For exempt holding companies, the Act does not have as pervasive an impact on company operations exempt holding companies as it does on registered holding companies. For example, an exempt company does not have to file the numerous applications required of registered holding companies with respect to its financing and other routine day-to-day activities which are within a company's normal operating prerogatives. Furthermore, relationships between the parent holding company and its utility subsidiaries and other affiliates are not as closely scrutinized as they are for registered holding companies.

Nevertheless, the Act remains as a substantial impediment for exempt holding companies. For example, various acquisitions by exempt holding companies remain subject to Section 3(a)'s "unless and except" clause. This clause is extremely vague regarding the magnitude and form of diversification and permits the SEC to "second guess" the exempt holding company's management regarding the desirability of these acquisitions, an ability which it does not possess for other companies. This exposure to possible forced divestiture or loss of exemption imposes significant limitations on an exempt holding company's efforts to diversify into profitable activities.

There is no present justification for a statute like the Act to govern the non-utility activities of a holding company, one or more of whose subsidiaries are confined to the distribution of

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natural gas at retail. For example, the Federal Energy Regulatory Commission (FERC) regulates the gas transmission and storage activities of interstate gas pipelines, many of whom are heavily engaged in exploration and development efforts and other unregulated businesses, both related and unrelated to the gas industry. The FERC has effectively regulated their jurisdictional activities in a manner which assures that the ratepayer has not been hurt by the non-regulated activities of such pipelines. This is also true of distribution utilities that have engaged in gas-related or non-gas-related activities. State regulation of the utility function has been effective, without regard to either the extent or nature of the utility's diversified business activities.

For these reasons, A.G.A. has concluded that the Act is not necessary in the public interest; to the contrary, it is duplicative of other federal laws, it requires unnecessary and costly paperwork, and it places registered gas holding companies at a competitive disadvantage when trying to engage in activities that will benefit the gas consumer. Finally, diversification of various types of activities -- some closely related and others less closely related to the successful marketing of gas -- is important for the financial health of the gas industry. The Act unnecessarily impedes these efforts.

Conclusion

For the reasons discussed above, we urge this Subcommittee to support full repeal of the Public Utility Holding Company Act of 1935. Thank you for this opportunity to present our views to the Subcommittee on this important issue.

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Mr. SWIFT. Thank you very much, Mr. Smith.
Mr. Krull.

STATEMENT OF JOHN KRULL

Mr. KRULL. My name is John Krull. I am a small plumbing contractor up in Long Island, New York State. I am here with Harold Krainin. I am the president; Mr. Krainin is the attorney for the Nassau County Association of Plumbing-Heating-Cooling Contractors. We are affiliated with and also appearing on behalf of the New York State Association of Plumbing-Heating-Cooling Contractors, and the National Association of Plumbing-Heating-Cooling Contractors.

The plumbers on a national level have 6,500 members, one of the largest organizations of this kind in the country. The organization for the industry itself employs about 400,000 people, and we have receipts of about $21 billion, and we believe that these bills that favor large business utilities over small businesses are not good.

Moreover, we believe they are not good because these large business utilities are protected and they are guaranteed a profit, and that profit is based upon compulsory rates which the consumer must pay. We believe that any revision of PUHCA threatens to promote monopolization, and also encourages the destruction of contractors in the energy conservation market.

We know that removing the restrictions of PUHCA would encourage diversification into the markets of the small business contractor. We also know that the utility rate currently provides the guaranteed profits as I just mentioned.

We believe that the competition created by the utility may result in lower direct costs to the consumer in the short run. However, there is the hidden factor, the overhead and the bureaucracies if the utility is to be paid by all the ratepayers. Furthermore, as in most cases of monopoly, we are led to believe that once the monopoly is in force, prices tend to go up.

We believe that removal of the restrictions would encourage circumvention of other laws. As it stands right now, NECPA mandates or prohibits utilities from sales, service, and installation of energy conservation measures unless they were already involved in these activities prior to enactment, and we are already seeing new initiatives developing the contractor's market by these utilities that were grandfathered. We believe that to remove PUHCA would encourage other utilities to escape the prohibition of NECPA via holding company arrangements.

We also believe that removal of the restrictions would promote unfair anticompetitive behavior. Only the utilities have the assets to hire marketing, publicity, and economic experts to develop messages to the consumer, and they have far more assets than a small business contractor has. They can promote favorable prices through direct contact with manufacturers. They have direct mail access to the homes of consumers via enclosures. Every time that bill goes out they can put a mailing in that for their holding company. And the utility benefits from cross subsidization by all ratepayers, some of it mandated by statute. They perform the residential conservation service energy audits under NECPA. Small busi-

ness contractors must collect all of their costs for a job from that customer. Certainly contractors are in no position to offer rebates as utilities have done in the past.

When marketing through a subsidiary or directly, customer credit checks can be made by the utility. You can see how quickly the utility bills are paid. We as small businessmen do not have access to that.

I am going to turn this over, if I may, Mr. Chairman, to Mr. Krainin, to finish this.

Mr. SWIFT. Mr. Krainin.

STATEMENT OF HAROLD KRAININ

Mr. KRAININ. Thank you, Mr. Chairman. My name is Harold Krainin. I am the attorney for the Nassau County Association of Plumbing-Heating-Cooling Contractors and have been such for over 20 years and am very familiar with the problems of small plumbing contractors.

First if I may, I would like to express our congratulations to Congressman Corcoran on one of his auspicious events today, and want to assure him of the fact that we are here to oppose his bill and not his marriage.

Going back to the theme that Mr. Krull left off as to credit checks if I may depart from the prepared remarks for one moment, another example of a not so subtle but devastating method of unfair competition by a utility that we are confronted with is about to take place on Long Island, Long Island Lighting Co.

As an alleged test of good faith, it states it requires in cases of gas installations either a deposit from the customer or a copy of the contract that the customer entered into between the customer and the contractor for the purchase and installation of the gas equipment. As it happens, the evidence introduced this past month at a New York Public Service Commission hearing as to whether to allow Lilco to lend its subsidiary up to $1 million showed that the consumer received from Lilco only a letter requesting a copy of his contract for the purchase and installation of the gas equipment.

Now what this means is that the utility has in its possession the pricing structure in detail of every competitor which is conceivable to its subsidiary. Respectfully, this is an unheard of and unbelievable situation.

By their very nature, as publicly regulated businesses, utilities are a monopoly that reach into most homes and businesses in the service areas. Signs and marketing designate the presence of their facilities and remind us of their network. Every month we see their bill come in. Every month we are reminded of the names of the utilities when we write out our check. Thus when they sell, install, or service equipment on their own or when they do so through subsidiaries they have an immediate advantage of name recognition before they even print the first advertisement.

In contrast, there are usually a number of contractors in an area. Although they compete vigorously, few have the capability to approach the name recognition of the utility because they do not have the same opportunities for comprehensive regular contact with consumers.

Again departing from the script, the utilities such as Lilco deem their name and logo to be a divine right that they create and make available only to their subsidiary at no charge to the subsidiary. We are of the belief that in essence, it is a name of considerable value created by the ratepaying public, and should not be allowed to be thrust into competition with any part of the ratepaying public.

If the utility takes over the contracting work, the injury is not only to the small business contractors, but also to the thousands of skilled mechanics they employ and to consumers who will find that they have less alternatives to choose from. The market disruption has already begun.

If utilities emphasize the sale of equipment, leaving installations to contractors, then the contracting industry loses its independent and competitive character and becomes beholden to them for business. Utilities enter the ranks of brokers of contracts. If the utilities pursue the installations as well, many small business contractors will be left bankrupt in the trail of a growing utility dominance.

Utilities have already made major inroads in the sale and installation and service of equipment which have traditionally belonged to the contractor. We have appended to our testimony examples of intrusions into the market.

While it has been suppressed here, and we would hope that the State public service and public utility commissions would stem the tide of the utility growth, that has generally not been the case. In Florida as in New York, the commissions have focused on energy conservation and have not been concerned with looking at the competitive impact, particularly on small business. In fact, at the recent New York Public Service Commission hearing I have alluded to, though we and others including the attorney general of the State of New York argued that the competitive aspects should be considered, the commission turned us down. As a result, the small business contractors who struggled to even make a profit are being forced to support their competitors.

Even more direct support is being provided by the utility rate which contractors must pay which include cross subsidization. Our conclusion is any analysis of revisions to PUHCA should go beyond an evaluation of utility company financing. Such analysis should consider the anticompetitive effects at least on small business contractors.

The act provides protection which must be maintained. Loss of that protection will result in a significant loss of small business and major market disruption. We are at the threshold of those changes. Rather than promoting the demise of small business contractors, Government action is mandatory to reverse the damage that has already been done.

In essence, the proposed legislation does nothing more from our point of view than to encourage the elimination of the concept and the words, "small business" from the vocabulary of doing business in the United States. We understand the President of the United States to be on record as favoring private enterprise and cutting fat from governmental and quasi-governmental institutions. Respectfully, utilities are quasi-governmental in nature.

To develop their growth at the expense of thousands of businesses just does not make sense. It is acknowledged that the public thrives on a free competitive market. These bills would help eliminate competition and unfairly.

The obvious results of this devastating blow to our industry is particularly obvious. Any question about there being a recession will result in depression. Any question of unemployment statistics will result in yet higher numbers and percentages of unemployed.

Small business is good. It is the weave that makes up the cloth of our country. Please don't allow it to be destroyed. Thank you. I would be happy to answer any questions.

[Testimony resumes on p. 505.]

[The prepared statements of Mr. Krull and Mr. Krainin follow:]

PHCC NATIONAL ASSOCIATION OF PLUMBING·HEATING·COOLING CONTRACTORS
1016 20th STREET, N.W., WASHINGTON, D.C. 20036 • (202) 331-7675

Mr. Chairman,

We are John D. Krull, President and Harold L. Krainin attorney for the Nassau County Association of Plumbing-Heating-Cooling Contractors. We are affiliated with and also appearing on behalf of the PHCC of New York and the National Association of Plumbing-Heating-Cooling Contractors. We have both been affiliated with the Nassau Association and NAPHCC for many years and we are familiar with the problems of the plumbing industry, particularly with respect to the small contractor.

The Nassau County Association is an organization that is comprised of small plumbing contractors, with its approximately 100 members. It is the largest local organization of plumbers in New York state.

The National Association of Plumbing-Heating-Cooling Contractors is the oldest national association in the construction industry and the largest in the plumbing-heating-cooling industry. It has over 6400 members. Membership comes from every state in the country and is organized through about 300 state and local affiliated associations. This industry employs over 400,000 people and has receipts of over 21 billion dollars.

We are appearing today to express our opposition to the 3 bills you have before you because of the adverse impact they will have on us as small businessmen. We believe that these bills favor large business utilities over small businesses. Moreover, these are large businesses that are protected and guaranteed a pro That profit is based on compulsory rates which consumers must pay.

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PUHCA discourages monopolization and encourages competition

The PUHCA was originally enacted to curtail abuses which may be less likely to recur today. However, it has also grown to fill another purpose which may be more important today -- the preservation of the free enterprise small business contractors. Revisions to the Act threaten to promote monopolization and encourage the destruction of contractors in the energy conservation market.

Utilities are frequently large businesses who are guaranteed a profit by the state public utility commissions. Our contractors are small businesses who compete vigorously to even make a profit.

With the increased attention being devoted to energy conservation, we already have seen a growth in utility activity in markets that have traditionally been the contractor's. Removing restrictions would encourage diversification into the markets of small business contractors. Utilities would be more free to devise stategies which enhance their strengths and to avoid the oversight of state public utility commissions. Even under existing law, utilities are reaching into our markets.

Utility rate structures provide for guaranteed profits or return on investment. Since the rate of return is set by the public utility commission, the utility must turn to increasing its investment which provides a larger rate base to enable it to increase profits. This, in turn, produces higher rates to the consumer.

The competition created by the utility may result in lower direct costs to the consumer in the short term. However, this hides the indirect costs for the overhead and bureaucracy of the utility paid by all rate payers. Furthermore, once monopolization

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occurs, experience indirectes that prices go up. This is certainly probable in this instance because the energy conservation efforts are not regulated.

As recently as the beginning of the last decade, utilities were aggressively promoting energy consumption to enhance revenues and investment. With the onset of the energy crises in the mid 70's, utilities sought new means to compensate for declining revenues and settled on increased penetration of the energy conservation markets to gain new income. They already had some involvement in service work. These efforts are now extending to sales and installation as well. Some utilities are anxious to establish good reputations which enhance their ability to branch out even further into these areas.

Removal of restrictions would encourage circumvention of other laws

Although the Securities and Exchange Commission supported repeal of PUHCA in their December 21, 1981 letter to a Senate Committee, they also noted the effect which the act has on competition by utilities. It notes that while the act only subjects 12 active holding companies to direct regulation, it "continues to have significant influence on the financing and diversification decisions of a much larger portion of the industry."

Quoting further, Chairman John Shad said "Utilities may be reluctant to form holding companies because they would then have to register under the Act or qualify for an exemption."

The National Energy Conservation Policy Act (NECPA) prohibits utilities from sales, service and installation of energy conservation measures unless they were already involved in these activities prior to enactment. We are already seeing many new

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initiatives involving the contractors' market by those utilities that were grandfathered. To remove the restrictions of PUHCA would encourage other utilities to escape the prohibition in NECPA through holding company arrangements.

Removal of restrictions would promote unfair anticompetitive behavior

Contractors and their mechanics are highly skilled and technically competent people. Normal requirements for plumbers are 4 years of classroom and on the job apprentice training to become a journeyman and up to 10 years as a journeyman to apply for a master plumbers license and work as a contractor. Two thirds of the states have licensing laws to insure the competency of plumbing contractors. Many of the remaining jurisdictions have local licensing laws.

More than 90% of the members of the National Association of Plumbing-Heating-Cooling Contractors are small businesses by standards set by the Small Business Administration. The median contractor nationwide grosses about one million dollars annually and employs a dozen mechanics.

During the last few years, there has been a great deal of public attention to developing public policy that promotes the health and viability of small business. However, even the larger contractors are finding that they are no match to the vast array of resources available to utilities.

Let me cite some examples.

Utilities can hire marketing, publicity, economic and technical experts to develop messages to the consumer. They can target efforts at particular products. The small business contractor cannot afford the overhead to develop these sophisticated marketing tools.

They can negotiate favorable prices through bulk orders

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directly with manufacturers. A contractor purchases products for installation from his supply house who in turn obtains them from the manufacturers.

Utility companies have direct mail access to the homes of consumers via enclosures with the regular utility bills. Small business contractors must cultivate every lead they get.

Utilities benefit from cross-subsidization by all rate payers, some of it mandated by statute to perform the Residential Conservation Service energy audits under NECPA. Small business contractors must collect all of their costs for a job from that customer. Certainly contractors are in no position to offer rebates as utilities have done.

Whether marketing through a subsidiary or directly, customer credit checks can be made readily by the utility by checking the payment record on utility bills. Such readily available credit checks are not as available to small business contractors.

Utilities frequently have financing programs at favorable interest rates for consumers. The consumer may be able to make payments on energy conservation measures over an extended period of time as part of the utility bills. Small business contractors seldom have the capital or cash flow to provide such financing arrangements.

When utilities or their subsidiaries expand or develop new energy conservation activities, risk plays a different role. If they loose money, they still have the rate base to fall back on. A small business contractor who seeks to expand or develop new markets may find it necessary to risk the whole company with no parent operations to fall back on.

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By their very nature as publicly regulated businesses, utilities are monopolies that reach into most homes and businesses in the service area. Signs and markers designate the presence of their facilities and remind us of their network. Every month, we see their bill come in. Every month, we are reminded of the names of the utilities when we write out our checks. Thus, whether they sell, install or service equipment on their own or whether they do so through a subsidiary, they have an immediate advantage of name recognition before they even print their first advertisement.

In contrast, there are usually a number of contractors in an area. Although they compete vigorously, few have the capability to approach the name recognition of the utility because they do not have the same opportunities for comprehensive regular contact with consumers.

If the utility takes over this work, the injury is not only to the small business contractors, but also to the thousands of skilled mechanics they employ, and to consumers who will find they have less alternatives to choose from.

Market disruption has already begun

The threshold for major market penetration has already been crossed. The risk of monopolization of the energy conservation market has probably never been greater. Utility involvement poses threats of major disruption of the market and to the structure of the contracting sector.

Sales of energy conservation products is one major area. Licensing requirements and other state and local regulations assure consumers of the integrity of contracting firms. Yet some utilities are apparently using only selected contractors for installation. The continued use of this practice will institutionalize a market allocation scheme.

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If utilities emphasize the sale of equipment, leaving the installation to contractors, then the contracting industry looses its independent and competitive character and becomes beholden to them for business. The utility enters the ranks of brokers of contracts. If the utilities pursue the installations as well, then many small business contractors will be left bankrupt in the trail of growing utility dominance.

Utilities have already made major inroads in the sale, installation and service of equipment which have traditionally belonged to the contractor. As an appendix to my testimony, I have attached a number of examples of these intrusions into our markets.

In a recent survey of our membership, 45% see sales and installation of gas fired appliances by utility companies. In addition, more than half of the contractors agree that utilities offer an unfair price advantage.

While we would hope that the state public service and public utility commissions would stem the tide of the utility growth, that has generally not been the case. As in Florida and in New York, the commissions have focused on energy conservation and have not been concerned with looking at the competitive impact, particularly on small business.

As a result, the small business contractors who struggle to even make a profit are being forced to support their competitors, the large utilities who are guaranteed a profit. Support comes in the taxes contractors pay which support Department of Energy programs institutionalizing unfair competition. However, even more direct support is provided by the utility rate which contractors must pay which include cross-subsidization.

Conclusion

Any analysis of revisions to PUHCA should go beyond an

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evaluation of utility company financing. Such analysis should consider the anticompetitive effects unleashed on small business contractors.

The Act provides protection which must be maintained. Loss of that protection will result in a significant loss of small businesses and major market disruption. We are at the threshold of those changes. Rather than promoting the demise of small business contractors, government action is mandatory to reverse the damage that has already been done.

Contractors are already facing increased utility competition in many parts of the country. Because of the competitive imbalance, such as cross subsidization, their control of resources, etc. we believe that that competition is unfair and anti-competitive Such unfair and anti-competitive behavior should be curtailed, not enhanced. Thus, we not only oppose changes that weaken the PUHCA, but we ask that you develop stronger measures to protect small businesses.

In essence, the proposed legislation does nothing more from our point of view than to encourage the elimination of the concept and words of "small business" from the vocabulary of doing business in the United States.

We understood the President of the United States to be on record as favoring private enterprise and cutting "fat" for governmental and quasi-governmental institutions. Respectfully, utilities are quasi-governmental in nature. To develop their growth at the expense of thousands of businesses just does not make sense. It is acknowledged that the public thrives on a free competitive market. This bill eliminates competition; and unfairly.

The obvious results of this devastating blow to our industry in particular is obvious. Any question about there being a recession, will result in a depression. Any question of unemployment statistics, will result in yet higher numbers and percentages of unemployed.

Small business is good - it is the weave that makes up the cloth of our country. Please don't allow it to be destroyed.

Thank you and I would be happy to answer any questions.

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Attachment

Cases of Unfair Utility Competition

Public Service Electric and Gas (PSE and G)

In New Jersey, the Public Service Electric and Gas Company is proceeding with plans to provide solar hot water systems to consumers. The program has been approved by the New Jersey Board of Public Utilities and the state Energy Commissioner under rules developed in accordance with the Energy Security Act of 1980.

Under this program, the systems will be made available to residential customers as a supplementary source for hot water. The major system components will be supplied by PSE and G and the installations will be made by contractors.

Beyond the loss of the opportunity to sell these systems, there are other disturbing features. First, a select group of only a handful of highly screened contractors who have demonstrated an ability to perform quality work at a reasonable price and in a business like manner will be used for the installations. What seems to be forgotten is that New Jersey has a statewide licensing law for contractors which assures consumers that any licensed contractor fits these criteria. Yet, under the authority of federal law, a regulated public utility is allocating this market under some presumed higher level of standards.

Secondly, the utility has argued that it must be able to carefully select the customers for participation in the program. For example, households must be less than five persons, have a roof in good condition and have a roof which faces in a southerly direction. They point out that they want to prove the success of solar to New Jersey homeowners. Certainly, these characteristics are reasonable to expect in a solar installation.

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Consumers may apply to have a system installed. However, it is the utility and not the consumer that is making the final decision whether the system will be sold and installed. The result is that the utility is selecting the cream of the crop, leaving potentially less successful systems for other contractors to go after. These run the risk of costing more or of producing less results because of the necessity of overcoming the handicaps which caused the utility to reject them. When energy conservation results are announced, PSE and G hopes to bask in the glory of a good reputation for its efforts at a reasonable cost. Meanwhile, other contractors may be saddled with explaining why ther projects were less successful.

Thirdly, the utility has offered a financing program to the consumer to assist in paying for the system. The larger financial resources of the utility give it a key marketing advantage not available to the typical plumbing-heating-cooling contractor.

Long Island Light Company (LILCO)

Last year Long Island Light Company (LILCO) conducted a similar program installing 600 solar systems.

A trade publication for the industry, Contractor magazine, best summarized the impact of this when they editorialized September 1, 1981.

> Even by signing contractors to install these systems, the utilities are playing their long-standing game of retail domination. Plumbing contractors who value their independent expertise stand to lose another strong base for a natural and potentially great business opportunity.
>
> It's that old story all over again, where captive contractors are rounded up for their mechanical skills and especially their licensed plumbing code connection. But these contractors get the crumbs of the labor-only part of the job, being eliminated from the sale of the equipment by the subsidized utility program with its high-powered advertising campaign.

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LILCO now has a proposal pending before the New York Public Service Commission to allow it to operate an independent subsidiary corporation named LILCO Energy Systems, Inc. The purpose of the new company is to sell energy conservation devices, solar energy systems, gas furnaces and heat pumps to Long Island consumers. LILCO is seeking to lend the subsidiary 1 million dollars.

The similarity in names will make any differentiation between the two companies indistinguishable to the consumer. Furthermore, if LILCO Energy Systems loses money in its operation, who will make up that loss? Any losses passed on to the parent LILCO will produce a loss in operating funds which the company will seek to recapture through adjustments in the rate base.

Thus, contractors face the threat of a large new company in the marketplace which benefits from name recognition and little fear of losses. Unfortunately, the Public Service Commission has prohibited testimony concerning the competitive impact of the LILCO subsidiary. The state Attorney General's office has formally objected to that exclusion.

Florida Power and Light

Last fall, Florida Power and Light (FPL) announced it was seeking bids from major manufacturers for 8,000 water heater insulation kits. Our Florida association reported to the Governor's Energy Office,

> The 10 largest plumbing/mechanical contractors in the state don't buy this item in such quantities. This is the primary reason why FPL claims its installation cost will be approximately $20, roughly half of a contractor's installed price. Contractors buy from suppliers, which puts a middleman in the economic scheme of things. Do the suppliers of Florida know that this giant corporate utility, protected by monopolistic statutes with a guaranteed profit, is going to be buying directly from the manufacturer?

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> The heavy advertising campaign planned by FPL will doubtless bring a great deal of awareness to the availability of these blankets. It is doubtful that Mr. and Mrs. South Florida, when they inquire as to price, will contact the neighborhood plumber. The contractors can't buy the blankets at FPL cost, plus he has an overhead cost such as truck insurance, worker's compensation, labor, etc.
>
> The contractor is traditionally paid at the conclusion of the job. FPL plans to add its cost to the customer's monthly statement. This convenient pay-as-you-go plan would be an unfair advantage.

A member of the Florida Public Service Commission acknowledged that all he wanted to do was conserve energy and that he was not bothered by unfair competitive practices.

Connecticut Natural Gas Corporation

The Connecticut Natural Gas Corporation operates a fleet for servicing residential equipment and has acknowledged to the Public Service Commission that they receive about 1% in profit from these operations. Questions have been raised whether the contracting operations reflect the costs of overhead which contractors must cover or whether some of the costs are being included in the rate base. Thus service work would be cross-subsidized by all rate payers. The Public Service Commission has ordered the utility to keep separate books for the contracting operations, but those have yet to be forthcoming.

In addition, there are charges that only "select" contractors get contracts from the utility.

Lone Star Gas

Lone Star Gas has appealed to the Waco, Texas, City Council for exclusive ownership of supply lines. The local contractor association has charged that this would

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allow the utility to become "more monopolistic than they already are." One contracting firm has estimated that the proposal would cost him $75,000 a year in business and require the release of two employees.

Similar proposals are scheduled for consideration by the town councils of Temple and Hewitt, Texas and the Lone Star proposal in Robinson was voted down.

Piedmont Natural Gas

Action has been filed before the North Carolina Public Utility Commission charging Piedmont Natural Gas with subsidizing its operations for the supply and installation of gas water heaters.

Piedmont is alleged to be including costs from these operations in the rate base which is paid by all rate payers. Contractors are loosing business to the utility through this unfair cross subsidization.

Wisconsin Power and Light Company

The Wisconsin Power and Light Company (WPL) has been selling solar water heater units at $1.00 over costs. Our local contractor association advises us that the units were being sold and installed for less than what the contractor can get the units for from the wholesaler.

In addition, the company has initiated service maintainance contracts for furnaces for $59.95. They sell water heaters and other energy conservation devices and they provide low interest financing.

Recently, WPL and other Wisconsin utilities have sought to establish holding companies. Under this arrangement, the parent company would oversee the utility business, which is regulated and promote other operations through the unregulated business.

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Northwest Natural Gas

When Northwest Natural Gas began selling and installing gas water heaters and providing a $150 rebate, contractors saw their sales plummet. The gas company hired its own service people to do the installations so that even contractors on the company's list saw their share of installations drop to zero. When the utility was in the business of replacing thermocouplings a few years ago, contractor' share of the market dropped to 10%. The utilities charged $10 for the combination of materials and one half hour of labor while estimating that replacement actually cost them $34.00.

For installations assigned to contractors under current programs, the utility uses a referral list. However, the gas company is selective and contracts with some contractors and not with others. In addition, a suit initiated by a contractor association alleges that work is not necessarily provided to contractors, but rather is assigned to moonlighting repairmen.

Obviously, a utility company which reaches into the homes of all gas consumers is in a very strong market position. They get a large number of calls and are in a key position to refer work. As a public utility, they should have an obligation to deal with bona fide contractors in a fair and equitable manner.

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Cases of Fair Competition

Equitable Gas Company

Columbia Gas Company

People's Natural Gas Company

The Pennsylvania Public Utility Commission is currently considering a proposal to transfer the responsibility for maintaining residential gas service lines in Pittsburgh, PA from the consumer to the utility companies. Thus, work normally performed by plumbing-heating-cooling contractors in the area would be transferred to the local gas companies. Fortunately, even the utilities in the Pittsburgh area, Equitable Gas Company, Columbia Gas Company, People's Natural Gas Company are opposing this proposal.

Equitable Gas has pointed out their objections:

1) The proposal is discriminatory against low income people who generally have short service lines and it will require subsidizing the wealthy who have larger lots and longer service lines.
2) Those who have recently had new lines installed at their own expense will be paying additional fees for others.
3) Utilities are less cost-efficient, both from a labor standpoint, due to work rules, and from a liability standpoint.
4) From economics, utilities would need to borrow money to subsidize installations. Both the interest charges and the higher operating costs would be passed on to consumers in the rate base.

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Minnegasco

The Minnesota Public Utilites Commission (PUC) has ruled that Minnegasco's program of servicing and installing customer appliances is a non utility function. The PUC concluded that all gas customers should not be required to shoulder costs from Minnegasco's service and installation operations and costs associated with it should not be included in the rate base.

As a result of the decision, Minnegasco has included all of its costs, such as overhead, in developing its schedule of service rates. Customers will now pay for normal service at the rate of $29.95 for the first half hour and $42 for each additional hour. Special services and service contracts are also priced to incorporate all costs of providing the services.

Contractors in Minnesota have hailed the decision as a victory and they expect to compete much more successfully.

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Mr. SWIFT. Thank you very much. We have a vote which may either be one vote or conceivably it could be a series of two or three votes. We don't know that quite yet. I think what we will do is recess, come back and get Mr. Hempling's testimony as soon as we have completed those votes. I will make a point of calling back if in fact this is going to be any more than a 10-minute delay.

The committee stands in recess.

[Brief recess.]

Mr. SWIFT. The subcommittee will reconvene, continuing the testimony with the first panel and the last witness. Mr. Hempling.

STATEMENT OF SCOTT HEMPLING

Mr. HEMPLING. Mr. Chairman, my name is Scott Hempling. I am the legislative representative for the Citizen Labor Energy Coalition. I would like to address the problems today with respect to the natural gas consumer. There are some unique concerns that natural gas consumers have. The special problem is that over half of the ultimate retail price of gas is determined before it ever reaches the States.

Another special problem with natural gas is that the price is heavily influenced by OPEC and by the international oil companies. This means that State legislators, State utility commissions, and the people they represent have little influence over the costs they ultimately pay and are particularly dependent on Federal regulation by the Congress, by the Federal Energy Regulatory Commission and by the Securities and Exchange Commission, so the key issue for the natural gas consumer is what type of company is going to provide this essential commodity to them.

What the natural gas consumer sees as the key benefit of the act is that it prevents interstate pipelines from purchasing retail distribution outlets. How does it do that? The purchase by an interstate pipeline of retail outlets would bring the pipeline within the confines of the act, subject the pipeline to regulations that we have heard about today, and also could result in the forcing of the pipeline to divest itself of other acquisitions. The result is that interstate pipelines are hesitant at this point to purchase retail gas utilities.

The special problem that results when an interstate pipeline purchases a retail outlet becomes clear when you look at what is happening to the natural gas industry today. There are numerous large interstate pipelines that have already purchased production facilities and natural gas wells such as Texas Eastern, Columbia, El Paso, Transcontinental, Texas Gas and Michigan and Wisconsin.

The problem is that as pipelines acquire production, the ability is there for the production subsidiary artificially to inflate the price that the pipeline pays. The pipelines' accounting costs rise. They are then passed on to the local utility by virtue of regulations by the Federal Energy Regulatory Commission, and the State public utility commission is then required of course to pass it through to consumers. The result is that the interstate pipeline has the ability to charge a price that is really equal to the price that an unregulated pipeline would pay.

The retail utility as a result cannot shop around, and new pipelines will have difficulty serving the area, because of the method by which the FERC now regulates pipelines.

There is one argument that natural gas distribution utilities have raised, and that is that the FERC will adequately regulate the prices charged by producers to pipelines so that there will not be any artificial inflation of the price. If you look at the recent FERC treatment of this, you will find out that their recent statement on the fraud and abuse section of the Natural Gas Policy Act suggests that the FERC will not scrutinize the prices charged by producers to pipelines.

The fact is that imprudence alone in the purchase by an interstate pipeline of gas will not be enough for the FERC to disallow the passthrough. The fact that cheaper gas is available to the interstate pipeline will not be enough for the FERC to disallow the passthrough of cost, and the fact is the opportunity does exist for the interstate pipeline to pay too much for gas.

What happens next if an interstate pipeline purchases a retail outlet is that it really sews up the market power that it has so far accumulated because of its ownership of production. The utility, because it is owned by the interstate pipeline, will not switch to alternative pipelines. It will not intervene in support of another pipeline who is seeking certification to serve the same load, and the fact is of course that consumers cannot switch utilities; so what you have as a result is an entity which is producing the gas, which is transporting the gas through an interstate pipeline, and it is then the same entity which is marketing the gas at retail to consumers, and there is no adequate regulation along the way. It is these special concerns of the natural gas consumers that suggest to us that we ought to retain the Holding Company Act.

There are other benefits that the act provides to consumers other than gas consumers. It of course prevents diversification by the utilities. It prevents consumers from having to shoulder the risks entailed when a utility company involves itself in other businesses. Certainly the investors will profit if these businesses are profitable, but if the other businesses are not profitable, the credit rating of the utility goes down, and of course local consumers will have to pay more for the interest costs associated with that decreased rating, so in our mind the Holding Company Act still provides important benefits both to natural gas and to electric consumers.

Without the proper regulation that the act provides, natural gas consumers would be subject to excessive costs and risks that companies now enjoying monopoly power could obtain from captive consumers. We ought to view the act as one views the standing army. We don't want to eliminate or weaken the army just because we don't use it every day.

The Holding Company Act is there as a deterrent to any would-be monopolist who is seeking to acquire monopoly power. With that, I will be happy to answer any questions.

[Testimony resumes on p. 514.]

[The prepared statement of Mr. Hempling follows:]

TESTIMONY OF

SCOTT HEMPLING
LEGISLATIVE REPRESENTATIVE
OF THE
CITIZEN/LABOR ENERGY COALITION

BEFORE THE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER
OF THE
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES

June 9, 1982

Mr. Chairman and members of the Subcommittee. We appreciate very much the opportunity to testify today on the need to preserve the Public Utility Holding Company Act of 1935. The Citizen/Labor Energy Coalition which represents over 200 citizen, labor union, senior citizen, religious and alternative energy organizations,is very concerned about efforts to repeal or seriously weaken the 1935 Act. Consumers of electricity and natural gas, for the most part, are captives of the local utilities which serve them. The Public Utility Holding Company Act is part of a framework of federal and state regulation which not only provides consumers with protection from the abuses of monopoly power, but also insures that utility service will be provided at rates that accurately reflect the actual costs of providing such service.

In its important 1971 study examining non-utility investments of regulated utilities an ad-hoc committee of the National Association of Regulatory Utility Commissioners (NARUC) stated,

> The "investment-revenue cycle"* has to continue to function effectively if utilities are to raise the large amounts of capital required to meet present and future demands for their vital service. 1/

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The ad hoc committee noted that "the practice of siphoning off substantial amounts of utility revenues to affiliated suppliers or service companies, thereby inflating substantially the total revenues needed to support any given investment" represents a serious "threat to the investment-revenue cycle." Such practices are outlawed by the Holding Company Act. As a result the financial integrity of utiiities subject to the Act is preserved, while consumers are assured that what they pay for is what they get.

For over 45 years the Public Utility Holding Company Act has protected electricity and natural gas consumers from costly financial manipulations and abuses on the part of utility owners and managers. Some utility executives, hoisted on the petard of their own miscalculations and short-sightedness, are now urging the repeal of this law on the grounds that it prevents their companies from raising needed capital. These companies argue that the Act prevents them from diversifying their investments and thus insuring a financially healthy utility. What they do not say is that they would like to use the creditworthiness of the utility operation to diversify into more risky ventures that may pay off at higher rates than continued investment in the utility. If the venture is successful, the primary beneficiary is the utility company stockholder, not the ratepayer. As the National Association of Regulatory Utility Commissioners concluded in 1971,

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> If a public utility engages in substantial diversification and is successful, the principal beneficiary is the stockholder not the utility consumer. If diversification proves to be unsuccessful, the stockholder is injured and the risk is great that the utility customer will be injured as well. The stockholders of a utility may win or lose as the result of divserification, but the consumer bears the risks of failure without any commensurate participation in the benefits of success. 2/

Since we have had more experience dealing with the natural gas industry and very little experience with the electric utility industry, I would like to specifically address the importance of the Act with respect to the natural gas industry. Except for the three gas companies -- Columbia, Consolidated and National Fuel Gas -- which are subject to the Act, no other gas utilities are organized as holding companies subject to the Act. Nevertheless, the existence of the Act prevents interstate gas pipeline companies, for example, from acquiring gas distribution companies. If the Act were to be repealed or weakened in any way, it would open the door for the large interstate pipelines, which in most cases have diversified their operations extensively over the past 15 years, to integrate forward into distribution.

This poses a very serious problem for consumers. In view of the fact that the major interstate pipelines have diversified, primarily by becoming gas producers as well as transporters of natural gas, serious monopoly consequences would result if they also could acquire distribution companies. While interstate pipelines are regulated under the Natural Gas Act, deregulation of natural gas prices could enable pipelines to earn monopoly profits on their own production. Thus, the Justice Department has observed,

> If a pipeline's transportation facilities are subject to effective rate regulation, but no effective regulatory check exists over the price it pays for gas from its own production operations, the pipeline would be able artificially to inflate the price it pays for its own gas. This

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> will raise the rate-regulated pipeline's accounting costs, which the pipeline passes onto consumers. These additional "costs" will be additional profits to the pipeline's production arm and to the firm as a whole. Theoretically, by raising the internal transfer price of its own gas, the pipeline could obtain a profit for gas equivalent to that of an unregulated pipeline. 3/

Similarly, the Justice Department is also concerned about the consequences arising out of pipeline acquisitions of distribution companies. The Department points out that an acquired distribution company

> Acquisitions of distribution companies by natural gas pipelines can....confer market power on the pipeline or enhance that market power. A distribution company owned by the pipeline it serves is not likely to seek to switch to another pipeline supplier in the face of a rate increase by its affiliated pipeline. A wholly owned distribution company is also unlikely to intervene in support of an alternative pipeline supplier seeking certification to serve its load. Moreover, consumers of the distribution company are unlikely to be able to switch to another source of gas, because distribution companies are generally given a franchised monopoly by the state. 4/

Of course, it is the existence of the Public Utility Holding Company Act that prevents interstate pipeline companies from acquiring distribution companies. Acquisition would subject the acquiring pipeline to the provisions of the Act. These provisions would, in our view, require the pipeline to divest itself of many of its previous non-utility acquisitions. As a result acquisition of a distribution company would not appeal to pipelines, which is precisely why such acquisitions have not occurred.

By preventing interstate pipeline acquisitions of local gas distribution companies, consumers have been protected in a number of ways. The independent local utility, reflecting the needs of its customers, is often willing to challenge rate increase requests made by the pipeline company supplier. If the distribution company were part of the pipeline company, it would no longer fight pipeline rate requests. In addition, the local

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distribution company is willing to participate in both regulatory and legislative proceedings on the federal level often in opposition to the positions adopted by the pipeline companies. This is true, for example, with respect to the current debate over accelerated decontrol of natural gas prices. The organization known as Associated Gas Distributors (AGD), composed of gas distribution companies along the East Coast of the United States, steadfastly opposes accelerated gas decontrol, while the Interstate Natural Gas Association of America (INGAA), the organization representing interstate pipelines, favors an accelerated schedule.

Gas consumers have little enough protection as it is. By repealing or weakening the Public Utility Holding Company Act, consumers would be even more at the mercy of large, essentially unregulated gas companies.

Another public benefit of the Act is the fact that it prohibits companies subject to it from engaging in corporate take-overs, unless approved by the Securities and Exchange Commission. Without the Public Utility Holding Company Act, companies not engaged in the utility business could acquire local distribution companies. Under the Act, the acquisition of two or more gas distribution companies, would require regsitration as a utility holding company. Furthermore, the acquisition of just one distribution company would require an exemption under the Act. Thus, the Act prevents companies not in the utility business from acquiring local distribution companies. It is a prohibition designed to protect the financial integrity and creditworthiness of the distribution company and to keep it out of the hands of corporations which might otherwise seek to abuse the special status of regulated utilities.

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Still another benefit of the Act is the fact that it prohibits, unless the Commission makes a finding that it is in the "public interest," companies subject to the Act from engaging in conglomerate-type mergers. The Act requires that any merger by a company subject to the Act should provide a vital function to the utility. Thus, the Commission has allowed electric utilities, for example, to go into the coal business when the coal production is, for the most part, used to fuel the companies coal-fired boilers. This is an extremely important prohibition. Without it, a holding company could divert money received from the sale of natural gas or electricity to non-utility related investments. It could thereby increase its debt capital relative to equity capital and increase the risk, that is, increase the cost of financing, the utility. Such risks are not in the public interest, because of the necessity to insure reliable utility service at reasonable prices.

Without proper regulation as provided, in part, by the provisions of the Public Utility Holding Company Act, natural gas consumers would be subject to excessive costs and risks that companies enjoying monopoly power could obtain from captive customers. One should view the Act as one views a standing army. We do not eliminate or weaken the army, because we don't use it every day. It is there as a deterrent letting any would-be trouble-makers know that they would face a terrible adversary if they chose to violate the peace. The Holding Company Act is a deterrent to any would-be monopolist seeking to acquire monopoly power.

If the Act were such an anachronism, I doubt that there would be any effort on the part of the utility industry to repeal or weaken it. It is precisely because the Act requires either registration as a holding company, or exemption from registration as a holding compary--that is, coming under SEC surveillance -- that makes it so important. Obviously, in comparison to the period following its enactment, there is little, if any, effort to dis-

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member some of the holding companies against which the Act was specifically directed. Nowadays the Act is preventive. It works by restraining anti-competitive and anti-public interest activities in which utilities might wish to engage. Those who argue in favor of repeal of or weakening amendments to the Public Utility Holding Company Act are really seeking a return to the evils which required enactment in the first place.

FOOTNOTES

*"The financing of investor owned public utilities rests upon two inter-locking regulatory roles. First, investors furnish funds which are invested in facilities needed to provide public utility services. Regulatory surveillance of public utility security issues is intended, among other things, to assure that capital furnished by utility investors is indeed utilized to finance public utility facilities. Second, recipients of public utility services must pay enough for the utility's services to cover necessary costs and provide sufficient "return" to retain and attract required capital. The regulatory commission in fixing utility rates assures that over the long term the necessary revenues are forthcoming from utility customers." (from "Report of the Ad Hoc Committee on Non-Utility Investments," National Association of Regulatory Commissioners, 1972, p. 709.)

1/ Ibid., p.710.

2/ Ibid.

3/ From a speech by Ronald G. Carr, Deputy Assistant Attorney General, Antitrust Division, Department of Justice, before the American Gas Association, March 31, 1982, p.4.

4/ Ibid., p.9.

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Mr. OTTINGER. I want to thank Mr. Swift, the gentleman from Washington, for taking the chair and recognize him at this point for questions.

Mr. SWIFT. Thank you very much, Mr. Chairman.

Before I talk about something more specific, I think one of the key issues in all of this is whether or not if we were to make modifications to PUHCA or repeal it, there would be sufficient regulation remaining to take care of appropriate things in terms of the public interest.

For example, PPA has testified that the reason waters are calm is that we build a dam there. If we remove that dam, have we replaced that with other things that keep the waters calm. That is the basic question, because if in fact there are no other things there that will take care of these legitimate public concerns, then we probably shouldn't be tampering with this.

If they are there, I would appreciate knowing what they are. If we could have some discussion on that topic, I would be interested. I think that you responded to that concern as well. Why don't you begin?

Mr. NICHOLS. Thank you. If I remember correctly, back in 1935 when the act was passed, only 22 States had regulation of electric rates. I don't know of a single State today, that does not. Just yesterday I believe Mr. Schuler of the New York Commission testified that he thought that State regulation had the capabilities to do the job of properly identifying the costs that are associated with diversified utilities.

I think that is a very important point, but I think it is something of a red herring, as far as the issue of repeal is concerned, because the States and the Federal Energy Regulatory Commission already have this job with or without repeal. As my chart pointed out, some 79 percent of the energy served by the investor-owned industry is served by other than registered companies, so the task is there.

It is being handled now, and it must be handled appropriately for the ratepayers. So it is something of a red herring as regards repeal of the act.

Mr. SWIFT. Mr. Richardson.

Mr. RICHARDSON. I think the question of adequate regulations is certainly going to be addressed, I am sure, by the next panel, Mr. York speaking on behalf of the State commissioners, and as you know, they have expressed strong concern. They had concerns back in 1971-72 when they looked at this issue, and they are expressing similar concerns today. They certainly don't regard the act as unnecessary. They see it as very helpful in their own efforts to regulate utilities within their State.

I think what is more troubling is what are the effects of controls over unrestrained mergers. The act does provide controls over unrestrained mergers, and I think the examples that I set forth and that are contained in the letter that I submitted for the record gives adequate testimony to this fact, and I don't see that there are other reasonably available alternatives to prevent the extreme concentration of control in the electric utility.

Now, it is true that some States may have the authority to deal with acqusitions and mergers, but again we are talking about the

registered holding companies, we are talking about systems that are multistate in nature, and that very fact complicates if in fact it doesn't prevent their effective control over the creation of holding companies, and concentration of control in the utility industry in the interstate context.

Mr. SWIFT. Then is it a correct inference to draw from that that the question that we really need to decide, as far as whether or not PUHCA is duplicative, as to make a judgment as to whether the States can adequately handle the job. Is that the only safety net that would be there if PUHCA disappears or is significantly modified? Mr. Smith?

Mr. SMITH. I would like to add to Mr. Nichols' statement. He focused on the protection of the consumer at the State commission level. The other group that was to be protected by the act, of course, are investors. Since 1935 there has been an extension of the Securities Act of 1933, the Securities and Exchange Act of 1934, and the security markets themselves have developed strong policing systems in the free market. The security analysts, the credit standards applied by institutional investors such as insurance companies, pension fund managers, bank trust departments, the combination of those laws, the Federal securities laws, and the very active and thorough securities market are protecting the investor very adequately, I think, in all regards.

If you sit down, as I did last night—with I think it is section 2 of the act—and look at the evils that Congress was dealing with in 1935, I think you can take it clause by clause, and either cite vigorous State regulations, vigorous security regulations, or fundamental changes in securities markets as answering each of those problems today.

Mr. RICHARDSON. May I make one other comment?

Mr. SWIFT. Yes, Mr. Richardson.

Mr. RICHARDSON. There were not only abuses, but there were benefits from holding company structures back in the 1920's and 1930's, economies of scale and more efficient utility operations, and the act is designed to encourage and to make sure that holding companies continue to operate in the most efficient manner, and if they can justify their existence on that basis, they are permitted to exist in interstate commerce, and prosper, and I think the question of repeal would eliminate the SEC's authority or any regulatory authority's ability to make sure that the existing holding companies or new holding companies which might be formed in the future which would be interstate in nature do in fact promote efficient utility operations and efficient utility regulation.

In fact, this aspect of the act was a very significant element in the long struggle to interconnect the State of Texas with the rest of the Union. It was an element in the Central and Southwest Corp. case. That company was not interconnected with its affiliates in the State of Texas. Proceedings were instituted at the SEC level. They were also followed up with proceedings at FERC and the Department of Justice, finally culminating in provisions in the National Energy Act which provided FERC with some authority to interconnect those systems without making the utilities that operated within the State of Texas jurisdictional for purposes of FERC regulation. But it was that ability of the SEC to look at whether or

not the holding company was in fact operating as intended, promoting the most efficient utility operation, which served as the very beginning of that proceeding which then did bring Texas into the Union for interconnection purposes. Without the act who will perform that function?

Mr. SWIFT. Mr. Nichols.

Mr. NICHOLS. I think perhaps we have a number of red herrings on the table as regards the repeal of the Public Utility Holding Company Act of 1935. First, as regards the efficient operation of utilities, I represent a group of utilities that is very heavily regulated at both the Federal and the State levels. I can assure you that it is those rate regulatory bodies that address—and properly address—the efficiency of our operations to insure that we are operating in the best interests of our customers.

Second, I would like to suggest that as far as the concerns of small business, for example, I think we have to recognize that the Public Utility Holding Company Act of 1935 is not an antitrust statute or a procompetition statute in itself. The concerns of the plumbing and heating contractors and others, if there is a real concern, is an issue that perhaps should be raised in review of the National Energy Conservation Policy Act.

The Holding Company Act itself does not address those matters, nor should it address them. Downstream integration into conservation services is currently permitted under the Holding Company Act even for registered companies, and so I don't believe the subcommittee should be distracted by what I consider to be red herrings as regards repeal of the act?

Mr. SWIFT. Yes, Mr. Krainin.

Mr. KRAININ. Mr. Swift, if I may, our concern is such that there have been statements here that the State regulatory agencies afford rate protection to us, and this is in the anticompetitive small businessman area. We are here giving examples today where they don't. We feel that any erosion of the protection, however limited it may be by PUHCA—there is protection to the consumer here from anticompetitiveness—will be destructive and as you said create waves in a calm pool. To us it is not a red herring.

We see the destruction, or the proliferation, frankly, as Mr. Richardson—and we support his statement all the way up and down the line—of more public utility holding companies that are unrelated. That will have a greater impact on our way of life. Though it did address itself to investors, it certainly also addresses consumers. As Mr. Richardson pointed out in the letter he received from the attorneys as to the recent ruling of the SEC, the anticompetitive aspects were taken into consideration, and we would like that to still remain on the books for our protection.

Mr. SWIFT. I am sure I have consumed my time. Mr. Hempling, I believe, wanted to comment on this and then I will conclude.

Mr. HEMPLING. The hidden concern here as well, Mr. Swift, is what happens to price should we repeal the act? As I pointed out before, looking just at the regulation of natural gas prices, there is not a sunny time ahead of us. If you look at the Natural Gas Policy Act, and the Natural Gas Act, there are several key phrases which the current Commission is prone to interpreting in such a way as to be quite beneficial to producers.

The just and reasonable phrase, which could regulate close to half of the natural gas supply, as well as the fraud and abuse standard, with respect to those two items, the current Chairman of the FERC has made no bones about his interest in finding ways to raise the price of both new and old gas, should we then have a situation where the costs of this gas can be passed right through to consumers, there are no protections if the repeal of the Holding Company Act takes place.

With respect to local commissions, just looking at one particular problem, and that is monitoring of the intracompany transactions, if you can imagine the numerous types of transactions that will take place, the loans that will go back and forth, the personnel that will go back and forth, the sale of power back and forth, I can't imagine that there would be a PUC staff in the Nation, and I am sure the NARUC people will testify to this that will adequately monitor all those intracompany prices and make sure that the prices for power at the State level is a correct one.

Mr. SWIFT. It would seem one man's herring is another man's dinner, and that is something the committee will have to deal with. Thank you very much, Mr. Chairman.

Mr. OTTINGER. Mr. Collins?

Mr. COLLINS. Thank you. I wanted to go into this matter of how these different energy sources go up some way or another in a conniving fashion. The gentleman talked about oil, talked about gas. When they deregulated it, why wasn't it that gas went up to $2.50? Instead, it went down to near the $1 level. How do you figure that one out?

Mr. HEMPLING. Sir, if you would look at deregulation of oil from the time that deregulation began, which is when President Carter first began that subject in the middle of 1979, the fact is that prices rose from around 50 to 60 cents at that time, to the current price, which is well over $1.

Now, it is true that what President Reagan did at the beginning of his term is to speed that process along, and it is true that prices have dropped since then, that is for many reasons, including a worldwide recession.

Mr. COLLINS. But, let's just take the assumption that some way or another it is rigged. Why wouldn't they keep it rigged? Why would they have ever let it drop to $1? Forty percent of the rigs are down out in west Texas today.

In other words, if they could rig it, if it was possible, I don't think they would, but I mean why in the world would they have let the free market operate, which is exactly what has happened?

We have been in a free oil market.

Mr. HEMPLING. I believe that is correct. At this time, Congressman, there is not the same type of demand for the product that there was a year ago.

Mr. COLLINS. That is exactly right.

Mr. HEMPLING. But the fact is that as economic recovery comes along, I would expect the prices to rise again.

Mr. COLLINS. That is right. In other words, what you are saying is that the market price is determined by the law of supply and demand, and not by some kind regulatory fiat.

Mr. HEMPLING. Congressman, I don't think you can ignore the fact that the worldwide recession will allow prices to drop, but the fact that prices could more than double from July 1979 to the period just about a year ago suggests to us that there is not a fully free market operating in the oil and gas area.

Mr. COLLINS. Let's take gas. Deregulated deep gas, not long ago, sold for $9 to $10 per thousand cubic feet. Now pipelines are not taking that $9 and $10 gas and the new people coming in are trying to demand what they can.

The price of deep gas has broken, as you know, tremendously. Why would that have happened if the industry had in some way been able to regulate it? Why would we be suffering, and I use the word suffering in terms of the producer's viewpoint, why would he let the price drop if he could rig the market?

Mr. HEMPLING. Congressman, I still believe you can point to a lessening of demand. The fact is that natural gas prices are rising by close to 25 percent a year. That for the most part when you look at the prices charged by different producers, they are charging the highest price allowable in a particular category, and for the most part are not charging prices below that maximum.

Mr. COLLINS. That is not the open market gas, though, you are talking about. Gas that is selling under $5, as you know, the ratio is 1 to 6, and oil, if it is at $6 a barrel, that means it ought to be selling at $5.

You accept that, don't you, as far as economics in Btu's if it isn't up to $5, wouldn't they try to go as high as they could toward $5, just from the natural economics?

Mr. HEMPLING. I am sure that there are numerous producers who are doing that. I would guess that there are producers who aren't, but when the market situation——

Mr COLLINS. Do you know of any producer that wouldn't be trying to get the highest price he could?

Mr. HEMPLING. No, I wouldn't.

Mr. COLLINS. Anyhow, do you know of any cases where there has been any collusion in industry? It all follows supply and demand, doesn't it?

Gas today is in oversupply. That is what is really causing it to back down in price. At least that is the concept I have. Do you have any reason to believe otherwise? I am talking about open gas, gas that is completely deregulated.

Mr. HEMPLING. Congressman, the fact that I can't at this point point to instances of collusion doesn't mean that the act itself will not prevent such instances in the future, and I think that it is best to leave the act there and to provide the protection that it can provide.

Mr. COLLINS. I was on the Oversight Committee, and for 5 years I went through where liberals kept talking to me about the fact that the oil industry had in some way or another rigged the oil price, and we had extensive investigations.

You never saw such investigations, and they never brought out one solid case of price fixing. You know, people have the concept that our State regulatory authorities live in a closet.

Well, these guys are very alert, and they are very aggressive.

I want to go back to one thing that you mentioned. We were talking about the effect of competition. I believe in competition as strong as anybody in the world, and you are afraid, as I understand it, you have a fear that if we do away with the Holding Company Act, that some way or another we might get into, utilities might unfairly compete with private industry.

Mr. KRAININ. Yes, sir.

Mr. COLLINS. I tell you, when we had a hearing here a few years ago on going around insulating homes, it was the liberals on our committee, not the conservatives, that were advocating going up in everybody's ceiling. They were going up in the attics and insulate everybody's house.

We had a very extensive hearing on that subject, and at one time we even put it in a bill, and the only way that we got that thing removed was that some people said with all logic that we were going to have a few of those inspectors shot when they went around people's attics going into it.

Now, it was the private industry, the utilities, that resisted this very, very strongly. I have never seen any inclination of the industry to try to get into that business. Do you have any examples where they are aggressively or doing it because of legislative pressure out of a State?

Mr. KRAININ. Your Honor, if I may address you as that, sir—I am used to being in a courtroom—Congressman, I am glad you asked that question.

Mr. COLLINS. That is a good way to start.

Mr. KRAININ. In New York, it is called the HIECA, the HIECA Act.

Mr. COLLINS. That is the New York State law that you are suffering under.

Mr. KRAININ. That is right, and whether it is liberals or conservatives, who put it there we are suffering. I don't put any label on it one way or the other. The point is, if I may, this Public Service Commission hearing that I have alluded to was a petition by Lilco—Long Island Lighting Co.—to lend $1 million, up to $1 million to its subsidiary, which it formed, went ahead and put them in business to go out and sell, service, and install solar water heaters and the like including gas high efficiency equipment.

Now, immediately, they found out that they weren't supposed to do this before they got the approval of the Public Service Commission, so they stopped. They took the men, some of the men they took back into Lilco, and the others they found a friendly contractor. They put all of the men—this came out of the testimony, sir—put all the men on the payroll of this independent contractor, and agreed to pay them all of the costs that were required to pay for these men to do these HIECA audits.

They were now doing the HIECA audits for Lilco. Lilco contracted with the independent contractors to come in and do the HIECA orders we have to do and we will pay all of the men all of the costs and on top of that, we will give you a profit as well.

What has happened is that Lilco is paying for the costs of doing the HIECA audits. The ratepayers in addition are paying on top of this a profit margin to the independent contractor.

Now, two things. The first is the fact that the ratepayers are paying a sum in addition. In the second place, all of these HIECA men are going to be called back to the subsidiary, and they have testified to this, and what are they going to do when they get back to the subsidiary?

They are going to go out and make the sales to the people who are looking for energy conservation, and they will have a list. I mean even though the lists are supposed to be given to the parent, they will have in their pockets a list of the people who already want it, something that we can't garner, something that will not be made available to us, and respectfully, sir, this is the kind of what shall we say, subtle competition that nobody seems to be able to foreclose.

As I indicated before, the Attorney General of the State of New York asked the Public Service Commission to hear the anticompetitive aspects and they won't.

Mr. COLLINS. Let me just say this: That is an excellent illustration. I think you ought to be in Albany telling them that about every month. I agree completely with what you are saying, and we certainly don't ever intend to let our legislation create unfair competition.

The better and more often things are done with free enterprise instead of government the better off you are. I agree with you 100 percent, but your problem is in New York.

Mr. KRAININ. We feel that any lessening of the powers under PUHCA is going to help it all the way up and down the line, is going to help eliminate our ability to compete.

Mr. OTTINGER. The time of the gentleman has expired. Let me recognize at this point the gentleman from Illinois.

Mr. CORCORAN. Thank you, Mr. Chairman. First of all, Mr. Nichols, in recalling your testimony, you talked about this conservation investment company that you have, and you indicated that some progress has been made on it, but I got the feeling that you wished you could have proceeded a little earlier on it. Could you explain what the situation is?

Mr. NICHOLS. Yes, Mr. Congressman, I can. You are correct that we did delay our application for that conservation investment company, and the reason we delayed it is we had other applications then before the SEC, including the very important one concerning our coal ship. We in no way wanted to delay that multimillion-dollar venture, which we so desperately wanted to go forward with.

We didn't want to hold up that process in any way, because although we have had excellent cooperation from the staff, we realized that we were best served to take one thing at a time.

Therefore, we held up on that, but that request is now before the Commission.

Mr. CORCORAN. So, from a practical standpoint, your objective of developing this conservation development company was delayed by the current law embodied in the Holding Company Act?

Mr. NICHOLS. That is correct.

Mr. CORCORAN. Second, what other kinds of programs might you have in mind along the lines of the so-called soft energy technologies? I know you have been doing some work, some excellent work, in that respect. Could you tell us about it?

Mr. NICHOLS. In that area, we currently are studying the possibilities of a wood burner with a major industrial concern. We have a study under way for a western Massachusetts site, and it would be my hope that perhaps within the year, we will be applying to the SEC for permission to go forward with that particular joint venture operation.

In addition, with the cooperation of the SEC staff, we operate an energy institute. I can tell you that running schools is a tough way to make money, but we have broken even so far.

We are also providing engineering and construction services for other companies, once again with the blessings of the SEC. So our operations are significantly diversified.

However, the electrical end of the business continues to represent more than 90 percent of our profits.

Mr. CORCORAN. I have one more question for you, Mr. Nichols, before going on to Mr. Richardson, and let me ask that question now. As you know, both in your examination of the issue and certainly in listening to the comments of your panelists, one of the big questions is the question of cross-subsidization.

As I examine this matter, it would appear to me that the public utility holding company structure as a corporate structure, wherein you would have a separate subsidiary that would be a regulated utility business, and on the other hand, you would have other ventures which would be completely segregated, separate, and standing on their own in relationship to the parent company, but not connected in any way with the utility subsidiary.

Now, in that connection, one of the concerns, and I think it is a legitimate concern that has been expressed here, in fact, your associate raised the question, who sits next to you, and that is what about the opportunity for information, personnel, and other kinds of transfers to give an advantage to the overall parent company because of its involvement with the regulated subsidiary?

In that connection, I know, of course, one of the answers that I would proffer and others have is the dependence on strong and effective State regulations, but in order for the State regulators to be effective, it seems to me that they have to have adequate information, so if we were to make some modification, or even outright repeal of the Holding Company Act, what would be your attitude and what do you think would be the attitude of the Edison Electric Institute and its members, if at the same time there were to be added at the State level some requirements that information regarding the new subsidiary, regarding the new unregulated venture, be made available to the State public utility commissions, subject, of course, to the confidentiality concerns, but needed in order to provide the State regulators with the information on the basis of which they can fulfill their duty to protect their ratepayers?

What would be your attitude toward that kind of access for information?

Mr. NICHOLS. I hope I can remember all of the parts of your question, sir. Let me start with the last one first, and let me give you my own feelings, or my own belief regarding this need for information.

We as an industry have an obligation, a very real need, to give to our regulators at the State and the Federal levels all the information that they have to have to properly come to decisions regarding the appropriate revenue levels for our electric utility operation.

If we fail to provide that information, we know we will not get the rate decisions that are essential to our investors. So it is in our best interests to provide that information to the State regulatory agencies, and to the Federal Energy Regulatory Commission. We have done that and we will continue to do so without any question.

Now, obviously, as far as the new ventures are concerned, there is a confidentiality matter. In addition, I agree completely with your suggestion that the public utility holding company structure will make it easier not only for the utility, but for the regulator to properly identify those costs that are properly attributable to the regulated electric utility company.

I think it is unfortunate, and it is one of the reasons to repeal the act, that utilities are staying away from that structure, which is in the best interest of the ratepayer of tomorrow. This is because of the fear that they will come under the constraints of the act and incur all the costs that the gentleman on my left suggested.

I think that we should actually be encouraging that form of structure on behalf of the ratepayer, and I think if we do repeal the act, you will see more holding companies formed for this purpose. It will benefit the ratepayer, and make the regulator's job easier.

Mr. CORCORAN. Mr. Richardson, you have emphasized in your testimony and in your answer to several questions that a major concern you have about the repeal of the Holding Company Act would be the removal of the current authority that the act provides in connection with any kinds of mergers or acquisitions involving more than one utility.

I would just ask you whether or not you are familiar with my legislation, H.R. 5220, which continues the protection. Mine does not provide for an outright repeal. It continues the protection in section 9(a)(2), which addresses I think the problem that you have raised relative to mergers and acquisitions.

I just wonder if you are familiar with that section in my bill?

Mr. RICHARDSON. Yes, I am familiar with the fact that your bill deals only with presently exempt companies. It does, however, provide that exemptions, once granted, are effective forever, and that being the case, it seems to me that exemptions could be granted.

The utility company then forms a holding company which is exempt and not subject to SEC review, and the problems which we have seen and the problems which we think have been effectively addressed by the SEC would no longer be subject to review.

Mr. CORCORAN. But I reiterate the safeguard is still there, because independent of what would happen relative to either registered company, which would be affected by my bill or an exempt company which would be affected by my legislation, the protection with respect to mergers would remain, and so on that basis, I think it would seem to me, and I would be happy to work with you, but it would seem to me that the major concern that you have presented so far in your testimony is adequately addressed in my legislation.

We don't change the present law in that respect.

Mr. RICHARDSON. The major concern that I have addressed today in my remarks has been the question of mergers and concentration of control. In the testimony that I submitted, however, I address a number of other issues including diversification. We come at amendment or repeal of the act with a dual perspective.

One is, as utilities ourselves, we are interested in making sure that we are not squeezed out of business, that there is not a concentration of control in the utility industry. Our second perspective is as purchasers of power at wholesale. Some 900 public power systems purchase power at wholesale from investor-owned utilities, and we believe that there are problems, there have been problems in the past, in regulating effectively holding companies. And it is our concern, our second concern, that these utility systems, as purchasers of wholesale power, receive the protections that we think they are entitled to, and protections which we believe they do receive under the Holding Company Act.

So there are two basic elements to our concern over these legislative proposals.

Mr. CORCORAN. Before going to my last question, I want to address a question to Mr. Krull, let me just comment that you talked about the importance of the Holding Company Act relative to the economic considerations of efficiency and simplification in the organization of the public utilities.

I would just suggest to you that with some 20 people over at the SEC responsible for the administration of that act, you do not have a tremendous amount of staff capability, with all due respect to the quality of those people, to make those kinds of judgments.

In contrast, in my own State of Illinois, we have almost 300 people who are members of the staff of the Illinois Commerce Commission, of whom about 50 deal with that kind of question every day, and I would just submit that from the standpoint of the purchase of power on a wholesale basis or from the standpoint of protecting the ratepayers, that I would rather put my trust, and I would rather have the protection that could be afforded by that kind of staff capability, than 20 people currently in the SEC Division that has the responsibility to administer this act.

I agree with the gentleman who said that you are attempting, I think, perhaps with some success, to raise some red herrings here, that really are not serious considerations.

Let me ask a question, if I might, to the gentleman who is concerned about the cross-subsidy problem. I understand your concern. I think it is a legitimate concern. I think that in reviewing the Holding Company Act, we ought to be very sensitive to that problem.

Let me ask you this question: Would you have the same kinds of concern about your businesses, if, for instance, Sears, Roebuck & Co. were to enter into the marketplace at either your hometown or up in Long Island?

Mr. KRULL. Sears, Roebuck operates relatively close to my place of business. They are out to make a profit, and if they lose on their marketing strategy, they could go under. I find it inconceivable but they could.

The lighting company, on the other hand, as it exists right now, under PUHCA protection and under NECPA protection, if they don't make a go of it, everybody pays a little more. The rates go up.

Mr. CORCORAN. Do you think it is possible that Sears, Roebuck and Co. would, in order to develop a certain market penetration, ever consider the prospect of shifting funds from the very cash-heavy Allstate Insurance Co. into some other kind of marketing venture? Do you think that would be possible, that kind of cross-subsidization?

Mr. KRULL. I am not that well versed in insurance, though I doubt it very much, but I don't buy insurance from Allstate. I buy my electricity from Long Island Lighting Co., and you have got enough cases going on around the country now where the lighting companies are subsidizing other ventures at the expense of the ratepayer.

PUHCA is not the cure-all for this problem. Other legislation, other areas are really where we also have to go, but what we are saying is that with the Public Utility Holding Company Act as it stands right now, utilities can better be monitored, rates can better be monitored, the issues of cross-subsidization can better be monitored.

Take away PUHCA. The utilities don't want those controls placed on them that they have to have right now through the National Energy Conservation Policy Act.

They immediately form a holding company. We are both adults and we realize that there will be, I cannot conceive any other way that there will be abuse that will exist in cross-subsidization.

Mr. CORCORAN. Let me just make one final comment.

First of all, I think it is possible for a private company to assist one of its subsidiaries, and I would suggest to you that you are probably going to be better protected under some kind of reform of the Holding Company Act, for this one reason, and that is that, as I indicated, you have only got a very small staff today which is responsible for administering the act.

I don't think that they achieve all the wonderful things that you give them credit for doing, but on the other hand, if you have a public holding company structure, if you have a separate subsidiary that is regulated, another separate subsidiary that is unregulated, I wonder what would be the incentive for the State regulators, and this we will get to in the next panel, but what would have been the incentive, what would have been the reason for the State regulators to allow some increase in the cost of, say, electricity or gas service in order to get a little extra money to put over into some new venture?

It would be, especially if you follow the activities of the various State PUC's, almost impossible for that kind of thing to occur, and I think very much against any reasonable prospect of what they do, because their own effort today is to hold down rates, not to increase rates, in order to shift the company into some other business.

Mr. OTTINGER. The time of the gentleman has expired.

Mr. Rogers?

Mr. ROGERS. Thank you, Mr. Chairman.

Mr. Nichols, I have heard concerns voiced that if the public utilities were able to own nonutilities-related businesses, that consumers would end up paying the bill for unsuccessful business ventures.

How would you insulate ratepayers from losses in nonutility subsidiaries?

Mr. NICHOLS. Mr. Rogers, that is a problem that faces the regulatory agencies across the country today.

Mr. ROGERS. But I am asking you, not them.

Mr. NICHOLS. Right. And we now have diversified operations. I think you best insulate the diversified operations, the nonelectric utility operations, by putting them in a separate company. And I agree completely with Mr. Corcoran that if you will put it in a separate company, which it is easy to do under a holding company structure, it is easier for everybody concerned to isolate those costs. I agree they should be isolated. If I go into a nonelectric utility business and lose money, believe me I don't want our electric ratepayers to pay those losses. They will not, and they should not, and I assure you that the regulators that I deal with won't let this happen even if I wanted it to.

I also want to assure you that there is a wide mistaken understanding or a lack of understanding about our industry as regards a guaranteed profit. Having once had the unfortunate experience of operating a utility at a loss, a negative rate of return, I can assure you that there is no guaranteed profit assured the electric industry. We are uniformly earning much less than our allowed rate of return, and have been for many years. But to answer your question: Use an isolated and a separate company, make sure those diversified operations stay in that company, and that their costs are attributable to that company. And, if there is a loss, the investor will suffer the loss, not the ratepayer.

Mr. ROGERS. But how do you get the funds initially to put into the separate company? Those, I assume, would be the capital assets of the utility?

Mr. NICHOLS. There is a facetious answer which is "with great difficulty," because we are a beleaguered industry, and getting the funds together to go into new ventures is not easy. But we are attempting to bootstrap ourselves by getting into profitable ventures that require a minimum of equity. I will mention the guidelines we have in my own electric utility holding company system when we consider a new business.

No. 1, we consider how much equity is required. If very much equity is required, it is a no-no, because we don't want to raise new equity dollars when we are selling in the marketplace below book value. I think you all understand the reason for that, because every time we do, we impair the future earnings of existing investors.

The second thing we want to make sure of is that we bring something to the new venture in the way of knowledge or experience that is unique to our system, that gives us, we think, a good chance of making a profit in that venture. Everything we have done so far we think has met those two tests.

Mr. ROGERS. You lead me to my next question, and that is one of the concerns raised about the repeal is that utilities would curtail their investment in energy businesses, and become involved in

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businesses that are totally unrelated to energy or to the utility benefit of their ratepayers. Can you give me some indication of the kinds of businesses the public utilities are wanting to invest in by the repeal of the act?

Mr. NICHOLS. Once again, diversification is taking place with or without repeal. I have described the businesses that our own system is involved in today, engineering and construction services, transportation, the coal-fired coalship, and the energy institute business. I also mentioned the application that will put us into the conservation investment in management business, where we operate on a split-the-savings basis for the energy savings that we create.

These are the kinds of businesses that we have gotten into, and I think that we will perhaps get into a few more. But the question you ask is, Will this attention distract us from our obligation to serve our electric customers in tomorrow's energy world? And I would say absolutely not.

I think if our industry can be faulted for anything, we are perhaps overconscientious in that obligation to serve. We really fear that we will not have the resources in tomorrow's world to supply tomorrow's customers. I think the accusation that is most often made to utility management is we have tried to build too much, so I don't think that is a valid concern.

We have, I think, demonstrated our continued willingness to invest in the facilities needed to meet our customer's needs of tomorrow.

Mr. ROGERS. I yield back the balance of my time.

Mr. OTTINGER. I think we ought to proceed onto our next panel. I thank the witnesses for their participation. Just a couple of observations that I would make, and if anybody wants to comment on them, they may.

Mr. Nichols, you indicated the States do have the capacity to handle these problems on their own even if they are interstate ventures, and cited the example of New York. But isn't it true that there are a few commissions like New York and California, Illinois--there may be a few others—that are really well staffed to pursue these problems?

There are also a great many commissions that are grossly understaffed and would not be able to do the analysis that is necessary to be able to effectively regulate very complex and big ventures in interstate transactions.

Mr. NICHOLS. I certainly agree that some commissions are staffed to a greater degree than others, but we also have the Federal Energy Regulatory Commission with its staff for the interstate operations that you referred to, and I would suggest they are very well staffed.

Mr. OTTINGER. Is it on the State commission that you are relying to prevent cross subsidization?

Mr. NICHOLS. I would suggest both State and Federal, because our wholesale operations are regulated at the Federal level. I would further mention that that need is there today whether or not we repeal the act. If State commissions have to have an expanded staff, they are going to have to have an expanding staff ir-

respective of the actions of this committee on repealing the Public Utility Holding Company Act of 1935.

Mr. OTTINGER. The other thing, I suppose, in response to my colleague from Illinois is that, I don't think it is the staff of the SEC that exercises the principal restraint. The fact of the act being there itself and certain activities being inhibited—and there I think is where we really have to look and see what will happen if those restraints in the statute are removed.

It is not the 20 people down at the SEC that really makes that much of a difference. I think the pros and cons have pretty well been brought out here.

Thank you all for your participation.

We will hear next from John Shad, Chairman, SEC; Mr. Aaron Levy, Director, Division of Corporate Regulation, SEC; and Mr. Stanley York, chairman, Wisconsin Public Service Commission.

I wonder if you gentlemen would remain standing for a minute rather than sit down and then having to stand up again. Because of some of the questions involving improprieties and alleged improprieties of the SEC procedure, I would propose to swear in the panel. I hope there isn't any objection to that.

Would you raise your right hand, repeat after me: I solemnly swear the testimony I am about to give is the truth, the whole truth and nothing but the truth, so help me God.

[Witnesses sworn.]

Mr. OTTINGER. I wonder if we might not start out—without objection, the statements of all the witnesses will be put in the record in full. In accordance with the practice of the chairman, I would prefer to get into the issues than to hear you recite your testimony. I hope we can bring out the principal points in that testimony in the course of our hearing.

Let us deal first with the side issue that concerns us with respect to the procedure that was used in making the decision by the SEC that it would advocate repeal, in doing so in a closed meeting, without consultation with the State regulatory agencies or the consumers.

Chairman Shad, would you like to address yourself to that question?

STATEMENT OF JOHN SHAD, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY AARON LEVY, DIRECTOR, DIVISION OF CORPORATE REGULATION, BEVIS LONGSTRETH, COMMISSIONER, AND EDWARD F. GREENE, GENERAL COUNSEL; AND STANLEY YORK, CHAIRMAN, WISCONSIN PUBLIC SERVICE COMMISSION, ON BEHALF OF NATIONAL ASSOCIATION OF REGULATORY UTILITIES COMMISSIONERS

Mr. SHAD. Yes, sir.

Mr. OTTINGER. What was done?

Mr. SHAD. The decision to close the meeting was a unanimous one of the full Commission, and I would ask the General Counsel, Mr. Greene, who advised the Commission on that decision to respond.

Mr. GREENE. We relied, Mr. Chairman, on section 9(b) of the Sunshine Act, and that section provides that you may close a meeting

"if the premature disclosure of an agency action would be likely to significantly frustrate implementation of a proposed agency action."

This language is quite broad. There is not a great deal of legislative history, and, when this decision was made, we did not have the benefit of the District of Columbia Court of Appeals' views as to how section 9(b) should be interpreted. To the extent that we were considering possible legislation that was before the Congress, and what our recommendations would be, we felt that public discussion might jeopardize our continued oversight of the public utility holding company structure.

Moreover, we had taken the same course when we had considered in detail the ALI Securities Code. In this situation, where we were basically wrestling with what would be the most proper course for the agency, the recommendation to be given, we felt that it would be best to have the meeting closed. However, it is a very close legal question, and I don't say to you that it is obvious from the face of the statute as to how one could go on this.

Mr. OTTINGER. Do you think that a meeting of this nature would still qualify for closure under the law as it now stands after the *Common Cause* case?

Mr. GREENE. I think it is a very close matter that is not free from doubt, but I believe that that case involved budgetary options that the agency was considering. I think we still might have the right to close it if we were considering what course we might take with respect to controversial and sensitive legislation.

Mr. OTTINGER. As a matter of policy, why was it not felt advisable to both have the meeting open and to consult people who are most affected?

Mr. SHAD. I think for the reasons that Mr. Greene has mentioned. We could have impaired the ability of the Commission to enforce the law. We didn't know what issues were going to come up in the course of our discussions. There were extensive memoranda prepared on the pros and cons, and questions raised as to whether or not we were effectively implementing the law now. If that was a view of the Commission and yet the act wasn't repealed, we could find ourselves being confronted with litigants who were arguing that we weren't effective and using our testimony to impeach our performance.

It was a very uncertain area when we went into it, but I must confess that I am not thoroughly familiar with all the different sections of the Sunshine Act, nor until recently with this latest case, which came after out meeting.

Mr. LONGSTRETH. If I could just supplement that. We didn't go to the State regulators because we didn't know what our own position was. We couldn't very well poil them without having had a discussion among ourselves and with our own staff to review their recommendations first.

But you have the transcript of our Commission meeting, and in that transcript, which is quite lengthy, I think you will see again and again the expression of our tentative conclusions. We indicated that as far as we were concerned, from what we then knew, the act ought to be repealed rather than our approving any of the three amendments that had been sent to us for comment by the Senate.

We were hoping to come to a session such as this and such as they are having over in the Senate, and to listen and learn, and possibly our views would be changed or affected in one way or another by what we did hear.

I think it would simply have been impractical to go to the State commissioners before we knew what we thought ourselves about our own law.

Mr. OTTINGER. In the ordinary course of things, what a regulatory commission does when it is considering changes in the law is to set forth a procedure for consideration of the operation of the law, bring everybody in, hear their points of view, and then the commission would make a decision.

From the transcript, what appears is that the rush to judgment here was because Senator D'Amato was contemplating considering legislation and he wanted to meet some kind of artificial timetable, which seems somehow a very weak basis for not reaching a really considered decision.

Mr. SHAD. Senator D'Amato requested the Commission's opinion on three proposed amendments, and we proceeded to provide that opinion as promptly as we could with the meeting that we had within the Commission.

Mr. OTTINGER. I will recognize my colleagues on this subject first. Let's get it out of the way. I would like to express my own concern. It seems to me that the Commission has a responsibility to reach its judgments with the fullest knowledge it can acquire of the pertinent facts, and to short circuit that in order to be able to produce a quick answer for a Senate hearing just doesn't seem to me to be wise.

It requires a knowledge of whether the State regulators can in fact handle this kind of thing, what kind of transactions are likely to take place in the marketplace, how investors are going to be affected, and how consumers are going to be affected.

I would think, and would hope that in future decisions that the Commission makes, that orderly procedure would be followed, and if either I on this side of the House or some Senators on the other side want a quick decision, you just tell them we don't think we can render a quick decision on a matter that is this complex and has this kind of implications.

We think that we ought to hear from the people affected and reach a reasoned decision.

Mr. SHAD. Mr. Chairman, I would add that we knew of the prior study by NARUC of this area, and that this subject had been previously raised—Mr. York will be talking about it shortly—and I don't believe they have reached a consensus yet. They may have at the executive committee level but not at the local level.

We would still be having hearings right now, I guess, had we waited for their views.

Mr. OTTINGER. Do any of my colleagues want to address this line of questions?

Mr. COLLINS. I would comment, Mr. Chairman. I can well understand how, if you have a matter of substance you can have better thinking, more logic and better deliberations in a closed session than you can in an open session. Right now in Congress we are talking about the budget. Now, every time the Congressmen get on

that open floor, you hear more rhetoric and less real substance than anything in the world, and yet when they get ready to settle that budget question, you are going to find that Tip O'Neill and Jim Jones and Jim Wright on one side and Bob Michel and Del Latta and a few others are going to get in a back room, sit down and really talk sense. This matter of closing the door and talking impresses me.

I was in business for a long time before I came up here, and I will tell you we could get a lot more done when we sat around the table, the few people that were concerned, than we could bringing in all the press. That is something you don't have to put up with in private business. When you start talking before the press, when you start talking with every other group, you circumvent. You cover everything.

You were in private business, Mr. Chairman. Did you all go out and hold a public hearing every time in your business you were making a decision?

Mr. SHAD. I think you get very little done at a stockholders' meeting. The proxies are already in, and when you get it done is before the meetings.

Mr. COLLINS. I think the stockholder analogy is a very fair comparison because I keep reading the reports and I never see such generalizations as they turn out. I can well understand the chairman of our committee, what Mr. Ottinger is saying, that because of the nature of this—let me ask one other thing.

Does the Commission have a detailed record of what went on in that meeting?

Mr. SHAD. A complete transcript. The chairman has it, and also it has been made available to the public.

Mr. COLLINS. Did you have any off-the-record statements in there or do you literally just go ahead and give us a complete and total transcript?

Mr. SHAD. There are occasions when the meeting would be interrupted for some reason.

Mr. COLLINS. All the official meeting, just like here, though?

Mr. SHAD. Yes; it is fully recorded and transcribed.

Mr. COLLINS. Do you do it by voice or do you have a——

Mr. SHAD. We do it by voice. It is on tape. It goes directly onto tape, and then it is typed up.

Mr. COLLINS. Then it is typed up, so we get the complete, accurate translation?

Mr. SHAD. Sometimes the language isn't completely clear. Somebody will mumble or something, and we don't get it all, but by and large, you——

Mr. COLLINS. So we have the complete record here?

Mr. SHAD. Yes.

Mr. COLLINS. Has it been furnished our committee?

Mr. SHAD. Yes; it has.

Mr. OTTINGER. It was not made public or available until the committee requested it some 6 months after the meeting took place.

Mr. SHAD. Is that correct?

Mr. GREENE. That is right.

Mr. OTTINGER. But not in the ordinary course of things did it become public. Mr. Corcoran.

Mr. CORCORAN. Thank you, Mr. Chairman.

I can understand the concern about the procedure in considering the matter, and based on the testimony of the general counsel, I can also appreciate the fact that there is some doubt as to what the pertinent provision of the law means, but I would just say in passing, Mr. Chairman, that it may well be that they should have handled it differently.

But I suspect that the five commissioners, were they all here today, would testify again to the fact of the position that they took some 6 months ago, and I would hope that we would return to the major issue of this hearing, and that is to get their views on this very critical question of whether or not to modify the Holding Company Act, and I hope we wouldn't allow ourselves to become mired in this procedural mess.

Mr. OTTINGER. I thought I would get it out of the way first. One concern I have with respect to this is that the decision by the SEC may have affected the utilities' position with respect to PUHCA. It is my understanding that the EEI had planned to come in with amendments to PUHCA, and then they felt they couldn't go less far than the SEC went.

Do you think that is accurate? Do you think the industry's position to favor repeal—first of all, it wasn't made until after the SEC had decided to advocate repeal; is that correct?

Mr. SHAD. I don't know what their deliberations were. It is true we recommended repeal in December.

Mr. OTTINGER. Let us drop that aspect of it for the moment and go on to the substance of the issue. I think we might hear first from Mr. Levy, who actually administers the act with respect to what kinds of problems you actually deal with in administering this act at the SEC, and particularly what kind of things you do that ordinarily State regulatory commissions and FERC do not do.

STATEMENT OF AARON LEVY

Mr. LEVY. By way of background let me first mention what is commonly known; namely, that there are 12 active registered holding company systems subject to the Public Utility Holding Company Act of 1935.

It should also be noted that these 12 active registered holding company systems have $60 billion in assets, and in 1981 had $28 billion in revenues. The systems comprise 60 operating utility companies whose retail service areas extend over 24 States. That gives you at least a picture of the magnitude of the total operation of these systems.

It should also be emphasized that this statute is not merely an investor protection statute. Nearly every section of substance refers that these regulatory provisions and rulemaking authority under these provisions should be considered in the terms of the public interest, the interest of investors and consumers. That triad of interests is the cornerstone around which all these sections revolve.

We do not have jurisdiction at all over rates, retail or wholesale. Retail rates are governed by the State commissions and the wholesale rates for jurisdictional companies under the Federal Power Act are governed by the Federal Energy Regulatory Commission.

Our problems essentially are concerned today with financing. In 1935 and thereafter, for almost 20 years, we were concerned with the vast reorganization of the intricate and complicated holding company systems that were created during the 1920's, and Congress directed all holding companies that managed to comply with the integration standards of section 11(b)(1), that each holding company is limited to an integrated gas or electric utility system, which is specifically defined in section 2(a)(29) of the act, and many holding companies were liquidated, dissolved, operating utilities were merged, consolidated.

Many of the operating utilities emerged have been spun off and became independent utility companies, as in fact was contemplated in 1935, when about that time nearly 85 percent of the utility system, the electric and gas, were members or parts of registered holding company systems.

That, by design of Congress and intention of Congress, has been eliminated. The 12 registered systems, which I have described, constitute about 18 to 20 percent of the electric industry, and the three gas holding company systems, which are subject to the act, comprise about 8 percent of the gas industry, including pipelines.

Since 1955, when substantially the vast program under section 11(b) has been accomplished, we have been concerned with financing, securities issues. These securities were issued by holding companies as well as by operating utility companies, and to give you the size and magnitude of the problems that we had to face, in the fiscal year 1981 we had $10.75 billion in security issues which had to be authorized under the Holding Company Act.

This year we are running about $5.8 billion through May of 1982. The main difference is that the short-term loans, which also require our authorization, had been somewhat less than they normally might be.

Now, when we are dealing with the financing of registered holding company systems, we are concerned both with the financing by the operating utilities as well as the financing by the holding company. The overall objective of the act is a simple conservative and prudent capitalization both for the operating utilities as well as for the holding companies, and as a working hypothesis, which is subject to some exception and flexibility, it generally consists, for the operating utilities, about 55 percent of long-term debt, approximately 35 percent common equity, and about 10 percent in preferred stock and short-term loans.

For the holding company, our general policy has evolved over the years, not only pragmatically case-by-case, and as a result of the vast experience of 20 years in the breakup of the holding company system, we have generally said that by and large a holding company which has only common stock in its investment portfolio should have no more, as permanent capital, than common stock and short-term loans in order to finance its subsidiaries, pending a refinancing by the issue and sale of common stock.

There are some exceptions that are possible, but it has to be under extraordinary circumstances, and by very definition an extraordinary circumstance means uncommon and infrequent.

Now, the problem is that the holding company itself must raise a substantial amount of capital in order to provide for its subsidiar-

ies. Holding company regulation and securities issues by holding companies are not in any way subject to State commission authority. State commissions have had general authority, in 1935 and increasingly so since 1935, over securities issues by the operating utility companies. But these two are interdependent, and they cannot be considered in isolation, because the objective is a simple and prudent capitalization, which is very important, because a utility must be conservatively capitalized. It cannot afford some of the things and the discretions of industrial companies, because a utility renders an essential and vital service.

It cannot in case of a recession, for example, close down or terminate or modify services. It has got to perform that service. That is vital.

Therefore, prudent capitalization should be so designed so as to make it work against the thrust and effects of adversity, as far as possible. We cannot make the utility depression-proof. Nobody can do that.

Therefore, since a utility has to finance, this is one of the problems in a financing of this magnitude. By the way, capital expenditures will be increased over the next 5 years. The best estimate I have seen is that utilities, electric utilities, over the next 5 years, 1982 to 1986, will require $165 billion in additional capital expenditures for plant and equipment.

We are fast running out of old plants and programs to be canceled, and we need that. The 5-year estimate reflects an inflation rate of 9 percent. These are the figures that have been published and supplied by the Edison Electric Institute.

If a utility has to finance, it must depend—and this is important—for 30 or 40 percent of its capital needs on the holding company, and holding company financing must be conservative and economically capitalized, which in turn depends on the prudent capitalization of the utilities.

If the utilities are heavily laden with debt, then their common stock which is owned by the holding company would also develop some kind of a speculative element and therefore it is important to keep it conservative, and at the same time the holding company, limited to common stock, provides at least a measure of stability both for the holding company as well as for the operating utilities to which the holding company contributes permanent common equity. That is one aspect of the program.

The other one I will mention briefly is the problem of acquisitions. Once a utility holding company has been organized, limited to an integrated utility system, as defined in the act, if it wishes to acquire another utility it must conform to various standards prescribed in section 10 of the act. Among them is the basic standard that it must tend toward the development of an integrated system.

In short, this is simply the converse of section 11(b), which says divestiture is required of what is not part of an integrated system. Section 10 is the converse of that a holding company should not be able to acquire that which it cannot retain or what it has been ordered to divest. The two sections work in tandem.

In addition to that there is also a provision in section 10 that the proposed acquisition shall not be detrimental to section 11. Section 11 is the heart of the statute. Everything else on the acquisition

side revolves around section 11, and that is the important thing, the acquisition is not to reconstitute or recreate that which had been undone over the years 1935 to 1955.

The same is true in case an acquisition by any company. For example, if a holding company is already an affiliate of one utility, it cannot buy another one. If a company wants to acquire the stock of an exempt holding company which has two subsidiary utilities, then of course it must get Commission approval subject to the same relevant standards. Exemption shall not be used, in other words, for purposes of evading at least some of the provisions, but in basic principle that is correct.

The other provision has to do with the acquisition of nonutilities. There we have a difference in connection with exempt holding companies and registered.

Section 11(b)(1) provides that a registered holding company may also retain other businesses which are economically necessary or appropriate or reasonably incidental to the operations of the public utility. This is generally known as the functional relation test. So that a holding company, for example, may acquire coal affiliates primarily for the service of its utility. It needs fuel, which it can acquire by contract. It can also do so by buying its own reserves and develop those. That is a functionally related business.

Also something called incidental businesses—for example, if a utility wants to go into the sale of appliances it doesn't have to go into that business, it doesn't need that service, but it is reasonably incidental to its utility service. That is not a static conception. For example, consulting services to develop and market the inherent talents and experience that have been gained and make that kind of a technique or know-how available to others, that also is an incidental service.

Energy conservation is another example. The utilities have a role to play either in developing programs or by financial support. Incidentally, this commission has approved these kinds of programs for registered companies even before Congress enacted the 1978 statute. In fact the Energy Conservation Act of 1980, has specified that any such business shall be deemed to be reasonably incidental or economically necessary, thereby affirming what had been left unsaid, namely, that it is a functionally related business.

Exempt holding companies are not subject to the act and do not need our approval in order to acquire other nonutility businesses. In 1973 in an evenly divided decision, two of four commissioners said that literally section 11, as to a functionally related business, does not apply to exempt holding companies. Nonetheless they said, we recognize that excursion into the nonutility ventures could present some hazards and some risks that a utility doesn't have.

Consequently, they laid down one condition, among others, that the proportion of the nonutility investments for the exempt holding company should be relatively small. The commission has not defined that. It meant to say if it is relatively small that to the extent there is a risk, the risk of loss will not significantly affect the utility.

But if the holding company should invest 50 percent of assets in a speculative enterprise and if it failed, it would have a marked

effect on the holding company, and consequently on its ability to provide capital and the cost of capital.

Now, one more point——

Mr. OTTINGER. I think we are going to have to save your one more point until we come back, there is a vote on the floor. We regret the interruption. We will be back as soon as we can.

[Brief recess.]

Mr. OTTINGER. We will resume and hopefully wrap up in a reasonable time. Hunger is taking over, I am sure, on everybody's part.

I was particularly sorry to have to interrupt your testimony, Mr. Levy, because I think having administered this act for some years, you have got more knowledge about it than probably any of us here. Why don't you continue. You were about to make a third point.

Mr. LEVY. One more brief comment, and that is concerning the exempt holding companies. I am focusing particularly on just two classes of exempt holding companies: One is the so-called intrastate holding company where a holding company and one or more utility subsidiaries organized in the same State and operations are substantially within the State. That is the intrastate holding company.

And another one is a company which is predominantly a utility company that serves in its State of organization and adjoining State, and it has relatively smaller utility subsidiaries for historical reasons or for reasons of State law. It is exempt under the act because it is primarily and essentially in economic terms a utility company, and that kind of holding company is granted an exemption.

All of these exemptions, these two plus all others, are subject to important qualifications. The statute provides in section 3(a) that the Commission shall grant the exemptions to such classes of holding companies unless and except to the extent that it is detrimental to the public interest and the interest of investors and consumers.

The Commission has adopted rule 2 which says the holding company can file a statement claiming the exemption without a formal application, in which case, if it is in good faith, meaning it prima facie meet the tests, the company is exempt unless the Commission later on pursuant to rule 6 terminates that exemption.

Incidentally, the Commission has authority to terminate an exemption even if it is granted by order, because section 3(c) states that, if circumstances have changed, the Commission may make or modify the exemption after appropriate procedures.

Today, under section 3(a) (1) and (2), there are 91 holding companies exempt in these two categories. Since January 1, 1978, 24 operating utilities have created holding companies which claim one or the other exemptions.

[The summary statement of Mr. Levy follows:]

Summary Statement of
Aaron Levy
Director, Division of Corporate Regulation
Securities and Exchange Commission
on the Administration of the
Public Utility Holding Company Act of 1935
to the House Subcommittee on Energy Conservation and Power

June 9, 1982

There are 12 active registered holding companies subject to the provisions of the Public Utility Holding Company Act of 1935 ("the Act"), with total assets of $60 billion and revenues, in 1981, of about $28 billion, and combined service areas extending across 24 states.

Financing. Financings by the holding company and subsidiaries require Commission authorization for the type of securities that may be issued, generally bonds (or debentures), preferred stock, and common stock, including holding company common stock. Securities must be reasonably adapted to earning power of systems and cost of capital must be reasonable. Typical consolidated structure is 55% long-term debt, 30% common stock (minimum), and 10% preferred stock and short-term debt.

Acquisitions. A registered holding company is prohibited, unless approved by the Commission, to acquire utility assets or securities, or a non-utility business. A utility acquisition must tend toward the economic development of an integrated system; a functionally related test applies to a non-utility acquisiton. In 11 years (1971-1981), non-utility expenditures totaled $4.2 billion.

Exempt Holding Companies. They are principally of two kinds: (1) the intra-state exemption, when the holding company and utility subsidiaries are organized in the same state and utility operations are substantially in that state (§ 3(a)(1)); (2) when the company is predominantly a utility but has relatively smaller utility subsidiaries. These exemptions are qualified and subject to the standards of public interest and interest of investors and consumers. Today, there are 91 companies claiming such exemptions.

For a full statement see Appendix C attached to statement of SEC Chairman Shad, dated June 2, 1982.

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Mr. OTTINGER. We will go to Mr. Shad next.

Why do you think we ought to repeal the act, and what makes you think that the States are going to be able to adequately protect investors and the public interest and consumers in what would appear to be fairly complex financing matters?

Mr. SHAD. The Commission proposes repeal because amendment would have left us with the appearance of responsibility without the ability to have oversight or direct involvement. We also concluded that the principal purpose of the act had been achieved over 20 years ago. As Mr. Levy referred to it, the heart of the legislation was the simplification or elimination of multitiered holding companies. That was accomplished over a generation ago.

To put it in perspective, at one time or another, since 1938, over 220 holding companies which controlled 1,000 operating utilities and 1,200 nonutilities were subject to the act.

That is over 2,400 companies. They stand at 0.5 percent of that number today. There are 12 holding companies that control 66 operating utilities and 53 nonutility subsidiaries.

The 12 holding companies are required to obtain prior commission approval of their intrasystem transactions, acquisitions, and financing. I think some of the statements that have been made suggest that the Commission is involved in rate regulation, which is simply not the case. We have no authority over rates. These 12 systems generate 20 percent of the Nation's electric utility revenues and 8 percent of the gas distribution revenues.

The act also inhibits the financing, acquisition and geographical expansion alternatives of the 91 exempt companies that Mr. Levy referred to, because of the "unless and except" clause. They are in a tenuous position, making plans, expanding and doing financing for other things subject to the Commission's ability to remove their exemption.

Also, I would like to point out that none of the Nation's other utility holding companies, which include telephone, sewage, pipelines, transportation, communications, cable television, and other industries, are subject to comparable SEC regulation or inhibitions.

Repeal would remove the element of unfairness now present in the application of the act's substantive provisions to a small fraction of the Nation's utilities.

The Commission has also concluded that if the Act is repealed, the economic, industry, and regulatory fundamentals which permitted the abuses of half a century ago will not recur, for the following reasons:

From 1902 to 1927 the Nation's electric energy generating capacity doubled every 5 years. Electric utilities were a dynamic growth industry, and notwithstanding their essentially unregulated monopolistic position, improving technology and economies of scale permitted them to voluntarily reduce their rates and therefore expand the demand for their services back in this explosive growth period, so there was the free enterprise system working. It made sense for them to bring down rates to the public.

They also benefited from the introduction of new electric appliances and equipment, and the rising urban population as people were moving to the cities from the farms.

These favorable fundamentals resulted in high rate of return on the capital actually invested in generating facilities, and paper profits were pyramided through highly leveraged multitiered holding companies. State and Federal rate regulation and disclosure requirements were lax to nonexistent. There were no uniform accounting standards, and assets were reappraised upward to facilitate financing. The investing public was unsophisticated, credit was cheap, and margin requirements were low, around 10 percent.

I think there is a very important point that hasn't generally been noted. Today, sophisticated institutional investors account for 70 percent of the market in listed stocks and half of the over-the-counter market. Credit is dear and margin requirements are high, 50 percent, as compared with 10 percent in the twenties.

Investment bankers no longer create and control utilities. Investment banking and brokerage has become a highly regulated service industry. Accounting standards are uniform and highly defined. The SEC enforces full and accurate disclosure by all issuers and surveils the securities industry and the accounting profession.

The Federal Energy Regulatory Commission has established uniform systems of accounts, approves utility issuances of securities where the State hasn't exercised its jurisdiction and regulates wholesale interstate utility rates. Most States and commissions have pervasive control of the books and records, consumer rates, issuance of securities, merger and consolidation, transactions with affiliates, property transfers, and other aspects of all, not just those, but all utilities doing business within their States, including those that are subject to this act.

Several States also regulate transfer of control, and all have the authority to, do so. The operating utilities controlled by the 12 holding companies represent a very, very small fraction of the utilities subject to State regulation.

I think it should be put in perspective. We are talking about 20 percent approximately of the electric industry, 8 percent of the gas. Therefore, the States now are regulating 80 percent of it. We are not talking about some explosive new major industry group. This is really a small piece of just electric and gas, not to mention other industries, which are huge, that are now being regulated by the States. I mention telephone and other holding companies.

Financial services, provide objective qualitative bond ratings. Holding company exempt securities have for years generally been rated lower than those of their operating subsidiaries because a principal source of holding companies' income is dividends from operating subsidiaries. Electric and gas utilities are no longer glamorous industries. Neither their image nor their economics will support highly leveraged multitiered holding companies.

Furthermore, if the act is repealed, these holding companies will continue to be subjected to the antitrust laws in terms of some of the concerns that have been raised here today. They will be subject to the SEC's registration and reporting requirements, and their operating subsidiaries will continue to be subject to the pervasive rate and other regulations of FERC and the State commissions.

A consistent misconception is that the SEC regulates utility rates under the act. Such has never been the case. Under the act, the SEC only regulates the 12 holding companies' intrasystem transac-

tions, acquisitions, and financings. It should be noted in the latter regard that over the last several years there has been a serious deterioration in the financial condition of the Nation's electric and gas utilities.

On balance, their bonds are being downgraded, their interest and construction costs are soaring, and their stocks are selling at 20-percent discount from book value. As of April of this year, the common stocks of the 12 holding companies that we are concerned with were selling at a 25-percent average discount from their book value. Nevertheless, they are being forced to do dilutionary equity financing in order to hold their bond and credit rates. This is like eating your seed corn. It provides a meal at the expense of next year's crop.

Other utility holding companies, which category includes AT&T on down, are not similarly restricted in terms of financing alternatives. They can and have sold convertible debentures, convertible preferred stocks, preference stocks, used warrants to reduce the interest cost on debt, engaged in leverage leasing, zero coupon bonds today, for which there is a large market in both domestic and Eurodollar markets. There can be negotiated or competitive bidding in terms of their finances, where by and large the regulated companies are limited to competitive bidding.

There must be a reason why the vast majority not only of utilities in this Nation but also industrials are using negotiated underwriting as an approach. They get an awful lot of service on a contingent-fee basis by doing so.

Obsolete plants need to be replaced and additional capacity is needed to meet future demands. In order to finance such requirements, these 12 companies must improve their profitability. Repeal of the act is not a panacea, but it will increase the financing, acquisition, and other alternatives, alternatives which these companies, like all other utility companies, should be permitted to pursue in order to improve their profitability and strengthen their financial conditions and which will, in turn, permit them to do a better job for the utility customers.

They are certainly not going to be able to do a better job serving their utility customers if their financial conditions continue to deteriorate; and, regardless of the profitability, repeal is long overdue. Congress has recognized the concept of sunset review and encouraged our agency and others to do it.

For all those reasons, the burden of proof on this issue should be upon those who would retain an act which served its purpose over a generation ago.

Those are my reasons for recommending to you today to consider repeal of the act. Commissioner Longstreth also has some comments.

[Testimony resumes on p. 676.]

[The prepared statement and attachments of Mr. Shad follow:]

STATEMENT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION CONCERNING PROPOSALS TO AMEND OR REPEAL THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

June 2, 1982

I. INTRODUCTION

Congress is now considering several proposals, introduced as S. 1869, S. 1870, S. 1871, and H.R. 5220 to amend the Public Utility Holding Company Act of 1935 ("Act" or "1935 Act"). Three of these bills would effectively repeal the Act as it applies to particular industry segments. The fourth, S. 1869, so extensively amends the Act as to approach repeal for the entire industry, although some administrative responsibilities would be left with the Commission. Together they approach total repeal.

The Commission does not believe that effective repeal of the Act as to one industry segment could be justified without considering whether the basic premises of the Act as applied to all public utility holding companies are still valid. While S. 1869 approaches repeal, it would leave the Commission with the continued appearance of oversight in the face of severely reduced regulatory authority and no clearly surviving purpose for the remaining regulation.

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After considering these proposals and evaluating the results of its administration of this statute, the Commission concluded that the Act had accomplished its basic purpose and that its remaining provisions now, to a large extent, either duplicate other federal or state regulation or otherwise are no longer necessary to prevent recurrence of the abuses which led to its enactment. The Commission has therefore unanimously recommended that Congress repeal the Act. This recommendation was transmitted to Senator D'Amato in a letter dated December 21, 1981. Since the Commission's decision, repeal legislation has been introduced in Congress as S. 1979, H.R. 5465, and H.R. 6134. _/

This statement explains the Commission's reasons for recommending repeal of the Act. It includes a summary of the events which led to passage of the Act, a description of the holding company structures which the Congress sought to eliminate, and review of the Act's administration by the Commission for the past 47 years. This information is essential to understanding both the structure and the complexities of the Act and the Commission's reasons for now recommending that it be repealed.

The Commission's decision to recommend repeal of the 1935 Act was based primarily on significant developments since 1935 in federal and state regulation of electric and

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_/ A brief summary of the amendment proposals is attached as Appendix A. The Commission will provide the Committee with detailed technical comments on these proposals and also on the repeal bills if so requested.

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gas utilities, the disclosure and financial reporting requirements now applicable to most publicly-owned companies, and changes in the accounting profession and the investment banking industry. Developments in all these areas now provide investors and consumers with a wide range of protections unforeseen in 1935. In addition, the present maturity of the utility industry, not to mention its financial difficulties, makes recurrence of the boom mentality and accompanying speculation that characterized the industry in the 1920's unlikely and perhaps impossible.

Other factors were considered in the Commission's determination to recommend repeal. The very thoroughness of the industry's reorganization pursuant to the 1935 Act raises questions about the continued fairness of subjecting the remaining 12 registered systems to the Act's detailed substantive regulatory requirements. This issue is made even more acute by the Act's requirement that the Commission base its actions on the economic merits of financings or other transactions proposed by the management of registered systems, thereby involving the Commission deeply in the substance of fundamental management decisions. In making these substantive economic determinations, the Commission is directed to act in the interest not only of investors, but of consumers as well -- a mandate that differs significantly from the other federal securities laws, which are administered for the protection of investors and focus primarily on disclosure and on the integrity of the nation's securities markets.

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Finally, the Commission believes that the continued need for the Act must be considered in the context of the substantial changes that have occurred in the electric and retail gas industry since 1935. This industry is no longer the highly profitable business it was when the Act was passed and for many years thereafter. While the 1935 Act did not cause the industry's problems and its amendment or repeal would not resolve them, the Act is premised on the assumption that public utilities should be structured in a particular way, with stringent geographical limitations and restrictions on investments outside the utility industry. Congress has not reexamined these basic presuppositions since 1935. Questions are now being raised as to:

a. whether the limitations on diversification and geographical expansion are in the best interests of investors and consumers;

b. whether the generation of electricity is still a natural monopoly; and

c. whether the 1935 Act discourages non-utilities from undertaking cogeneration projects or otherwise acts as a barrier to entry by non-utilities into the area of generation.

Continuation of the 1935 Act constitutes, in effect, a judgment that the industry today should conform to a structure deemed best in 1935. The Commission believes that the Congress should consider whether the Act now locks the public utility industry into a structure that is no longer responsive to changing market conditions or to the nation's energy needs.

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II. HISTORY AND STRUCTURE OF THE 1935 ACT

A. Growth of Public Utility Holding Companies

The twenty years preceding the stock market crash of 1929 saw intense growth and expansion of the electric and gas utility industry in the United States. In the electric industry, generating capacity approximately doubled every five years between 1902 and 1927. _/ This extraordinary growth resulted in part from population increase and concentration in cities, as well as from the extension of service into new territories. In addition, improvements in technology and equipment resulted in the construction of larger and more efficient generators and expanded the area of economical transmission, thereby enabling the industry to concentrate generation of power in relatively large and economically-operated central stations. The industry's growth was further enhanced by the intensive market development made possible when progressive price reductions permitted the application of electric energy to many new purposes. _/

Similar, although less spectacular, growth occurred in the gas industry -- most notably after 1925 due to extension of interstate gas pipelines. The quantity (in cubic feet) of

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_/ I.R. Barnes, The Economics of Public Utility Regulation 31 (1942) (hereinafter "Barnes"). See also Federal Trade Commission Report to the Senate, "Utility Corporations," S. Doc. No. 92, pt. 72-A, 70th Cong., 1st Sess. 24 (1935) (hereinafter "FTC Report"), conducted pursuant to S. Res. 83, 70th Cong., 1st Sess. (1928).

_/ Barnes at 31-33.

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manufactured gas _/ produced and marketed in 1929 was over five times greater than that in 1906. _/ Moreover, the value of natural gas marketed in the U.S. increased more than 880% over the same period, after the pipelines greatly expanded the industry's markets with a product much cheaper than manufactured gas. _/

Prior to 1920, holding company systems often brought great advantages to local utilities by combining small plants into interconnected regional systems. _/ In addition, the larger holding companies had access to the capital markets on better terms than small independant operating utilities. The larger, combined holding company systems could attract more skilled management and the expert engineering necessary to address the

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_/ When the Act was passed, most of the retail gas supplied in large parts of the nation was manufactured, principally from the process of reducing coal to coke. Because the process had become increasingly expensive, many smaller gas plants were closed and even metropolitan gas utilities became unprofitable. Extension of the availability of natural gas, particularly after the construction of major interstate pipelines in the 1930's and 1940's, resulted in an almost universal substitution of natural gas service, or propane gas distribution in areas inaccessible to the pipelines.

_/ FTC Report, pt. 72-A at 32 (Table 7).

_/ Barnes at 29 (Table 5).

_/ J.C. Bonbright, Public Utilities and the National Power Policies 23-24 (1940); see also 10 SEC Ann. Rep. 84 (1944).

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problems involved in plant construction and in the production, transmission, and utilitization of electric energy. In their early stages, combinations of electric and gas utilities in a holding company system facilitated improvement and extension of service, encouraged greater consumption, and led to reductions in the costs of production and, ultimately, to lower rates for the consumer. _/

During the 1920's, however, holding companies acquired numerous and widely scattered utility properties throughout the United States and even in foreign countries. These acquisitions frequently bore no economic or functional relationship to other properties in the holding company system. Instead, vast and sprawling utility holding company empires were created and continued to grow enormously in the speculative period up through 1929. For example, the consolidated assets of the Associated Gas and Electric system grew from approximately $6 million in 1923 to $1 billion in 1929. __/ The capital assets of the North American Company grew from $9.2 million in 1901 to $132.7 million by 1929. __/

Holding company expansion in the 1920's was often stimulated both by investment bankers, who saw opportunities for profits and commissions from the sale of securities, and

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__/ FTC Report, pt. 72-A at 881.

__/ 10 SEC Ann. Rep. 84 (1944).

__/ FTC Report, pt. 72-A at 192.

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by promoters, who saw opportunities to increase the sources from which they collected fees for management or engineering services. The realization of the variety and magnitude of available gains to be derived from the highly profitable and growing electric and gas industry caused intense competition among holding companies for the acquisition of yet more utility properties, in the course of which prices were frequently driven up to two to five times book value of the equity securities. _/ Acquisitions were frequently funded by the issuance to the public of debt securities based upon the inflated acquisition prices, with the expectation that the utility's earnings would cover these interest expenses and provide a profit to the parent holding company as well. Between 1924 and 1930, utility holding companies floated an estimated $5 billion in securities, the proceeds from which were used to purchase outstanding voting securities of additional operating utility companies -- that is, further expansion of the holding company empires -- rather than to build or improve utility properties. _/

One result of this competition among holding company empires was the increasing concentration of gas and electric utilities in fewer and fewer holding company systems, sometimes

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/ FTC Report, pt. 72-A at 60-65. In an extreme example, one holding company paid a price 159 times book value for a controlling equity interest in another holding company. Id. at 64-65.

/ 10 SEC Ann. Rep. 84 (1974).

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under parent company managements that were neither experienced nor interested in local community needs. By 1932, eight major holding company systems controlled more than 67% of the electric energy generated by privately-owned plants. _/ During 1930, holding company systems also controlled 66.4% and 23.3% of the national production of manufactured and natural gas, respectively. _/ Four holding company systems controlled more than 50% of the total natural gas pipeline mileage and 15 holding companies controlled over 80%. _/ Gas and electric utilities were often combined under the control of a single holding company. For example, in 1930 the Electric Bond & Share group of holding companies controlled 7.4% of the total U.S. production of natural gas and 14.4% of the total electricity generated by privately-owned plants. _/

B. Holding Company Structures

This concentration of control was frequently accomplished through highly-leveraged financial structures at each level of the multiple tiers of partially-owned subsidiaries. Effective

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_/ FTC Report, pt. 72-A at 38 (Table 12).

_/ Id. at 48 (Table 16).

Id. at 46 (Table 14).

_/ Id. at 38 (Table 12) and 47 (Table 15).

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control of extensive utility complexes was thus achieved through minimum equity investments in the parent companies. _/ While enough voting stock was held within the systems to assure control, the great bulk of the capitalizations were represented by non-voting debt and preferred stocks held by the investing public. Generally five or six sub-holding companies separated the top parent from the operating utilities. In at least one instance, there were 12 companies in one line of control from top to bottom of the pyramid. _/

The pyramided capitalizations and corporate structures were often accompanied by "write-ups" of the assets of both the operating and holding companies, based on appraisals of utility properties by affiliated entities, frequently on sketchy evidence and without any check by state or federal authorities. This practice further decreased the equity investment required to control vast systems. Following the write-up of newly-acquired subsidiaries' assets, debt securities sold to the public would recoup initial cash outlays with the controlling common stock retained at little or no cost.

_/ The top holding company in the Associated Gas & Electric system provides an extreme example of the complex capital structures in these giant holding company systems. That holding company had a capitalization consisting of 3 classes of common stock, 6 classes of preferred, 4 classes of preference stock, 24 classes of debentures (some convertible into equity securities at the company's option), 7 issues of secured notes, 4 issues of investment certificates and various warrants and rights. 10 SEC Ann. Rep. 86, n.5 (1944).

_/ FTC Report, pt. 72-A at 159.

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As a result of the highly-leveraged capital structures, small percentage increases in the earnings of the underlying operating companies were phenomenally magnified at the level of the top holding company's most junior equity securities. A conservative illustration in the FTC Report of the effects of pyramiding on the common stock earnings of the top company in a pyramid of five holding companies over the operating utilities shows a possible 295% return on net earnings of 8% on the underlying properties. Of course, this leverage also worked in reverse so that even the relatively small decreases in earnings of the operating companies during the early 1930's _/ had a significant impact on the top-heavy superstructure of holding company debt and preferred securities. Many companies within these systems stopped paying dividends and defaulted on debt securities, and some of the largest systems were forced into bankruptcy.

The investing public suffered losses of millions of dollars. The complex capital structures of these holding company systems, together with the lack of uniform accounting standards, also afforded many opportunities to direct profits or losses through intercompany channels. Such transactions obscured the true financial condition of the various companies within the system

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_/ FTC Report, pt. 72-A at 162-66 (Table XI).

_/ Electric and gas operating companies actually suffered less during the depression days of the early 1930's than almost any other substantial segment of the economy. Their operating revenues only dropped about 15% from the peak levels of the 1920's. 25 SEC Ann. Rep. at XVII (1959).

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to the detriment of investors and the frustration of state regulators' efforts to establish fair rates for consumers. _/

C. Congressional Findings

Even before the 1929 crash, the vast size of public utility holding companies and the increasing concentration of control in the electric and gas industry caused Congressional concern. Pursuant to a Senate Resolution in 1928, the Federal Trade Commission ("FTC") undertook a study of the entire industry that spanned nine years and ultimately comprised 101 volumes. _/ A second, 6-volume study was conducted by the House Interstate and Foreign Commerce Committee between 1933 and 1935. _/ These studies identified myriad questionable practices and concluded that public utility holding company systems, as they

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_/ Comments of the Securities and Exchange Commission on the Comptroller General's Report of June 20, 1977, to the Congress on the Administration of the Public Utility Holding Company Act of 1935 at 6 (hereinafter "SEC Comments").

_/ FTC Report, supra note __.

_/ Report on the Relation of Holding Companies in Power and Gas Affecting Control, H.R. Rep. No. 827, 73d Cong., 2d Sess. (6 Vols. 1933-35), made pursuant to H.R. Res. 59, 72d Cong., 1st Sess. (1932) and H.R.J. Res. 572, 72d Cong., 2d Sess. (1933). The investigation that resulted in this Report was conducted by Walter M.W. Splawn, Special Counsel to the Committee on Interstate and Foreign Commerce, and the document is frequently referred to as the "Splawn Report" (hereinafter "Splawn Report").

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then operated, were detrimental to both investors and consumers. _/ These reports, which have been called "some of the most exhaustive and comprehensive studies ever to underlie a federal statute," _/ formed the factual basis for the 1935 Act.

The more significant conclusions were also listed in Section 1(b) of the Act and are briefly summarized as follows:

(1) inadequate disclosure to investors of the information necessary for them to appraise the financial position and earning power of the companies whose securities they purchase;

(2) issuance of securities against fictitious and unsound values;

(3) overloading operating utility companies with debt and fixed charges, which tended to prevent voluntary rate reductions;

(4) imposition of excessive charges upon operating utility companies for various services, such as management, construction work, and the purchase of supplies and equipment;

(5) control by holding companies of the accounting practices and rate, dividend, and other policies of their operating utility subsidiaries so as to complicate or obstruct state regulation;

(6) the control of holding companies and their subsidiaries through disproportionately small investment; and

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_/ The FTC Report listed some 19 different general categories of abuses. FTC Report, pt. 73-A at 62.

_/ North American Co. v. SEC, 327 U.S. 686, 701 n.11 (1946).

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(7) the extension of holding company system control and dominance over far-flung utility properties without regard to the integration and coordination of related properties.

D. Structure of the 1935 Act

The 1935 Act today consitutues a relatively small part of the overall federal regulation of electric and gas utilities. Structurally, it is Title I of the Public Utility Act of 1935 and the Federal Power Act (which greatly expanded the functions of the Federal Power Commission) is Title II of that same statute. While the Federal Power Act focuses upon questions of engineering, science and economics as applied to ratemaking and licensing proceedings, the 1935 Act is oriented primarily toward financial transactions, corporate structures, acquisitions and dispositions of assets, and potential conflicts of interest. It may be for this reason that Congress originally assigned administration of the 1935 Act to the Securities and Exchange Commission rather than to the Federal Power Commission.

It should be noted that the Securities and Exchange Commisson has no ratemaking responsibilities under the 1935 Act. The Federal Power Commission (now the Federal Energy Regulatory Commission) was given ratemaking responsibility under the Federal Power Act _/ for wholesale sales of electric energy in interstate commerce. The 1935 Act also does not

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_/ 16 U.S.C. § 824 et seq.

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confer any jurisdiction on the Securities and Exchange Commission over gas pipeline systems, since the definition of "gas utility company" under the Act includes only those companies involved in the retail distribution of gas. _/ The Natural Gas Act of 1938 _/ conferred on the Federal Power Commission jurisdiction to regulate the pipeline systems through its authority to regulate wholesale sales of gas in interstate commerce.

The 1935 Act requires all companies that meet the statutory definition of a "holding company" either to register or seek an exemption. Registered holding companies and all their subsidiaries are then subject to significant substantive regulation under other provisions of the Act. Because of the complexity of the Act, its provisions are not identified in detail here but are discussed in a section by section analysis, included as Appendix B. The more significant requirements of the Act are summarized below:

1. Registration

Section 2(a)(7)(A) defines a "holding company" as any entity that owns 10% or more of the voting securities of an electric or retail gas utility _/ or of another holding company. The Act

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_/ Section 2(a)(4).

_/ 15 U.S.C. § 717 et seq.

_/ As noted, the Act's definition of "gas utility company" includes only those companies that own or operate facilities for retail distribution of gas. The definition of "electric utility company" is much broader in that it includes any company that owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale.

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requires all holding companies with subsidiaries engaged in the electric utility business or in the retail distribution of gas to register with the Commission or seek an exemption.

Because Congress did not consider all types of public utility holding companies to require regulation at the federal level, Section 3 of the Act authorizes the Commission to exempt holding companies from the registration and other provisions of the Act. The Commission is "directed" to exempt holding companies if they fall into one of five general categories. _/ However, under the so-called "unless and except" clause of Section 3, exemption is not required if the Commission determines that it would be detrimental to

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_/ The five categories for exemption are:

(1) when the holding company and its public utility subsidiaries are all organized and carry on their business substantially in one state (the "intrastate exemption");

(2) when the holding company is itself an operating public utility whose operations do not extend beyond the state in which it is organized and contiguous states (the "operating company" exemption);

(3) when the holding company is only incidentally a holding company and is primarily engaged in another business;

(4) when the holding company is only temporarily a holding company (e.g., a bank that acquires title to pledged securities);

(5) when the holding company is such only with respect to foreign public utilities.

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the public interest or the interest of investors or consumers. _/ The Commission may also revoke an exemption if it finds that the circumstances which gave rise to the issuance of the exemptive order no longer exist.

2. Integration and Simplification of Holding Company Systems

Section 11 spoke directly to the issue of undue concentration of control within the industry and to the overly complex capital structures and inequitable distribution of voting power. This section sets forth the basic integration and simplification requirements of the Act and has frequently been referred to as "the very heart" of the statute. _/ It authorized the Commission to reorganize the registered holding company systems so that each was restricted to a single integrated electric or retail gas utility system having a simple capital structure. Additional utility systems and related incidental businesses could be retained only if specified standards were met.

_/ Section 3(a) provides that the Commission shall exempt holding companies and their subsidiaries that meet the criteria of that section from "any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers."

_/ SEC v. New England Electric System, 384 U.S. 176, 180 (1966), citing, North American Co. v. SEC, 327 U.S. 686, 704 n.14 (1946).

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Geographic and other limitations on the business of a registered holding company system are set forth in Section 11(b)(1) of the Act, which requires that each registered system be limited to a "single integrated public-utility system." The term "integrated public-utility system" is separately defined for electric and gas companies, but in both cases refers to a group of naturally related properties within a single area or region. Early in its administration of the Act, the Commission interpreted the single system requirement to mean that electric and gas properties within a registered system could not together constitute a "single integrated utility system." / A registered holding company must satisfy the standards for retention of an additional system if it desires to retain both an electric and a gas utility system.

Under Section 11(b)(1), non-utility businesses could be retained by a registered system only if "reasonably incidental or economically necessary or appropriate to the operations of [an] integrated public-utility system." In administering this provision of the Act, the Commission concluded that registered systems could retain businesses that supplied or served the utility system, such as coal mines or transportation systems.

/ In Re Columbia Gas & Electric Corp., 8 SEC 443 (1941); In Re United Gas Improvement Co., 9 SEC 52 (1941). This interpretation was sustained by the Supreme Court in SEC v. New England Electric System, 384 U.S. 176 (1966).

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In addition the Commission concluded that retention of gas and electric appliance businesses also met the statutory standard.

The Act's corporate simplification provisions are set forth in Section 11(b)(2), which requires elimination of unnecessary corporate complexities and redistribution of voting power on a fair and equitable basis among the securities holders of the entire holding company system. "Great-grandfather" holding companies were prohibited through the section's requirement that no more than two holding companies could exist over an operating utility in a registered system. This section also required many holding company systems to recapitalize to achieve a simple structure with voting rights equitably distributed among all investors, and many intermediate holding companies were dissolved during this process. _/

3. Regulation of Financing, Acquisition and Disposition of Assets, Service Arrangements and Conflicts of Interest

Registered holding company systems are subject to substantive regulation of, among other things, all financings, acquisitions and mergers, and transactions with affiliates. These requirements were intended to prevent recurrence of holding company abuses by regulating the "activities of holding companies and their

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_/ 10 SEC Ann. Rep. 89 (1944).

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subsidiaries * * * that were found to give birth to many of the evils about which Congress was concerned." _/

The more significant of these regulatory provisions include:

(1) Financings: Prior Commission approval must be obtained for most types of securities issuances by registered holding companies and their subsidiaries (Sections 6 and 7). Approval may be withheld if either the securities or the terms of their issuance fail to meet specified qualitative standards. Under Section 7, the securities may not be approved if the Commission finds, inter alia, that the security is not reasonably adapted to the security structure of the issuer and other companies in the same holding company system or not reasonably adapted to the earning power of the issuer, or if the financing in question is "not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest. "

(2) Acquisitions: Prior Commission approval must be obtained for acquisitions of any securities or utility assets or any other interest in any business by registered holding companies or their subsidiaries (Sections 9 and 10). The Commission may not approve any acquisition that would be detrimental to carrying out the integration and simplification provisions of Section 11, which means that utility acquisitions must be confined to a single geographically-defined area and that non-utility acquisitions must be functionally related to the utility operations.

(3) Loans and other intercompany transactions: Loans from an operating utility to a parent holding company are prohibited and other types of intercompany transactions, such as loans from the parent holding company to the utility, are subject to regulation by the Commission (Section 12). The section also provides for Commission regulation of sales of public utility securities or assets and the solicitation of proxies and prohibits certain political activities.

_/ North American Co. v. SEC, 327 U.S. 684, 710 (1946).

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(4) Contracts with affiliates: The Commission is authorized to regulate service, sales, and construction contracts between operating utilities within a registered system and associate companies, a term which includes other companies within the same system (Section 13). This section includes a statutory requirement that such services be performed at cost.

(5) Periodic reports: The Commission may require the filing of annual, quarterly, and other periodic reports by registered holding companies, and may require such reports to be certified by an independent public accountant (Section 14).

(6) Accounting practices: The Commission is authorized to establish the form of accounts and prescribe uniform methods for keeping accounts (Section 15).

Holding companies exempt from the registration provisions of the 1935 Act and operating utility companies generally are not subject to any of the above requirements, except to the extent that the same or similar requirements may be imposed under other federal laws. Section 9(a)(2) of the 1935 Act is a significant exception. That Section prohibits "any person" who already owns 5% or more of the voting securities of any public utility -- and is therefore a statutory "affiliate" of that company -- from acquiring 5% or more of the voting securities of another public utility without prior approval from the Commission.

III. COMMISSION ADMINISTRATION OF THE ACT

In the first few decades following passage of the 1935 Act, one of the Commission's major tasks was the reorganization of the electric and retail gas industry through administration and enforcement of Section 11(b) of the Act. There is a general

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consensus, which the Commission shares, that this task was completed at least 20 years ago.

As already described, Section 11 authorized the Commission to require that every registered holding company (1) limit its operations to a single integrated public-utility system, although it could retain, under certain circumstances, additional systems and reasonably incidental non-utility businesses, and (2) simplify its capital structure through the elimination of unnecessary holding companies and the equitable redistribution of voting power among security holders. The Senate Report expressly acknowledged that this was the most important part of the 1935 Act:

> "[T]he purpose of section 11 is simply to provide a mechanism under which effective federal and state regulation will be possible. It is therefore the very heart of the title, the section most essential to the accomplishment of the purpose set forth in the President's message." _/

Effective administration of the reorganization provisions of the Act began only after the Supreme Court's 1938 decision upholding the constitutionality of its registration provisions. _/ Even at the height of its administration of the Act, the Commission recognized that its functions under Section 11 were to a large extent self-liquidating. _/ By 1952, the Commission

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_/ S. Rep. No. 621, 74th Cong., 1st Sess. 11 (1935).

_/ Electric Bond & Share Co. v. SEC, 303 U.S. 419 (1938).

_/ 10 SEC Ann. Rep. 82 (1944).

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announced that "the task of bringing about compliance with Section 11 which had its real beginning in 1940 is rapidly nearing completion." _/ The Commission continued:

> "Thus, in what is probably the only instance of its kind in the history of the nation, an entire major industry has been almost completely reorganized in the short space of 12 years and this has been accomplished with a staff which has declined steadily from 175 in 1940 to the present force of 35 employees engaged in this work in the fiscal year of 1952. When the work under Section 11 is completed in another couple of years there will be no further expense to the taxpayers on this score." (footnote omitted). _/

In 1959, the Commission reported to Congress in connection with its activities under Section 11 that:

> "[S]ecurities of the divested companies and of those registered companies which have completed their integration and simplification programs have an excellent acceptance. The utility industry as a whole is enjoying financial health and stability, and has been able to finance expansion programs of unprecedented proportions largely out of new money raised from the public sale of securities." _/

At one time or another since 1938, a total of 2,419 companies were registered under the 1935 Act, including 223 holding companies, 1040 utility subsidiaries and 1156 non-utility subsidiaries. _/ Many of these 223 holding

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_/ 18 SEC Ann. Rep. 82 (1952).

_/ Id.

_/ 25 SEC Ann. Rep. XXVII (1959).

_/ 28 SEC Ann. Rep. 83 (1962). As used in this statement, the term "non-utility subsidiary" means a subsidiary engaged in any business other that that of an electric or retail gas utility, as those terms are defined in the 1935 Act.

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companies were intermediate ones serving no demonstrable economic purpose. As a result of the reorganization and simplification process mandated in Section 11, a total of 2,235 of these companies had been released from the regulatory jurisdiction of the Act by 1962. _/ Accordingly, about one-half of the largest utility companies presently operating are not subsidiaries of holding companies at all and are therefore outside the scope of the 1935 Act. In addition, a number of companies are currently exempt pursuant to Section 3 of the Act, approximately 90 of which because they are either predominantly intrastate or predominantly operating utilities. The Commission is not aware of any problems with the capital or corporate structures of either the independant operating companies or the exempt public utility systems.

The number of active registered holding company systems has been reduced to 12, __/ consisting of 66 utility subsidiaries and 53 non-utility subsidiaries as of December 31, 1981. These 12 systems consist of 9 electric and 3 gas systems with assets and revenues as of December 31, 1981, as follows:

_/ Id.

_/ There is one registered system that is considered inactive: Philadelphia Electric Power Co. The sole function of this company and its subsidiaries is to hold title to the Conowingo hydro-electric project, which is operated under lease by its parent, the Philadelphia Electric Company, an exempt holding company. Licensing and title complications have precluded dissolution of these companies, but they do no significant business.

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Holding Company	As of December 31, 1981 (000 omitted) Assets	Revenues
Allegheny Power System	$3,190,739	$1,607,461
American Electric Power Company, Inc.	11,567,039	4,192,645
Central and South West Corporation	4,643,244	2,055,318
Columbia Gas System, Inc.	4,616,781	4,426,243
Consolidated Natural Gas Company	2,850,653	2,738,164
Eastern Utilities Associates	426,821	297,931
General Public Utilities Corporation	5,054,021	2,065,487
Middle South Utilities, Inc.	8,318,556	2,771,788
National Fuel Gas Company (Sept. 30, 1981)	732,697	888,456
New England Electric System	2,292,085	1,282,101
Northeast Utilities	3,950,597	1,655,057
Southern Company	12,415,034	4,256,237
	$60,058,267	$28,236,888

These systems represent about 20% of the investor-owned electric utility assets and about 8% of gas utility asets. All are currently in substantial compliance with the geographical integration and corporate simplication standards of Section 11. The only reason for lack of full compliance is the continued retention of relatively minor gas operations by Middle South, American Electric Power, and Northeast Utilities.

The 1935 Act provisions in addition to Section 11 were intended to prevent recurrence of the abuses perpetrated through the public utility holding company structure in the 1920's. While most of these provisions do not apply to either exempt holding companies or to operating utilities,_/ they involve the Commission deeply in substantive management decisions of the

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_/ Section 9(a)(2) is an exception in that it applies to "any person" -- not just registered holding companies.

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remaining 12 registered systems concerning matters such as financings and acquisitions.

The great bulk of the Commission's current activity under the 1935 Act relates to the financing of registered holding company systems, the standards for which are prescribed in Sections 6 and 7. In the 12 month period ended September 30, 1981, the Commission approved total financings of more than $11 billion. Other provisions of the Act dealing with mergers and acquisitions, service contracts, and other intrasystem transactions also continue to require significant attention.

From time to time, the Commission must also consider applications filed pursuant to Section 9(a)(2) of the Act, which requires prior Commission approval before any person -- not just one of the 12 remaining registered systems -- may become an "affiliate" under Section 2(a)(11)(A) of more than one electric or gas public utility. That section defines an "affiliate" of a specified company in terms of ownership of 5% or more of that company's voting securities. _/

The Commission's records indicate that compliance with the Act in fiscal year 1981 required a total of 830 filings, applications, and reports from the industry involving an estimated

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_/ A more detailed statement of the Commission's administration of the Act, prepared by Aaron Levy, Director of the Division of Corporate Regulation, is attached as Appendix C to this Statement.

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69,000 hours to prepare. The Commission's Revised Budget Proposal for fiscal year 1982 shows that 20.3 staff years were devoted to 1935 Act administration in fiscal year 1980. Administration of the Act in fiscal year 1981 involved 18.2 staff years at a cost of $760,000. For fiscal year 1982, 17.0 staff years have been projected at an estimated cost of $795,000.

In June 1977, a General Accounting Office ("GAO") Report took issue with the Commission's view that its major responsibilities under the 1935 Act had been accomplished and questioned whether existing exemptions granted by the Commission should be continued. _/ The GAO Report recommended that Congress direct the Commission to make a study under Section 30 of the Act _/ of the developments in the gas and electric industry and determine the Act's continued overall usefulness.

The Commission response noted that the GAO criticisms were based, in large part, on a basic misconception of the Commission's role in administering the Act in that the reduction in the level of activity reflected attainment rather than abandonment of the

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_/ General Accounting Office, Report to the Congress, "The Force of the Public Utility Holding Company Act Has Been Greatly Reduced by Changes in the Securities and Exchange Commission's Enforcement Policies" (June 20, 1977) (hereinafter "GAO Report").

_/ Section 30 authorizes the Commission to make studies and investigations to determine the size, types, and locations of public utility companies which do or can operate most economically and efficiently in the public interest and the interest of investors and consumers.

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Act's purposes. In addition, the response pointed out that the evils and abuses which gave rise to the passage of the 1935 Act had been virtually eradicated due to vigorous enforcement by the Commission during its first three decades and stated that "Congress did not intend that utilities would remain permanent federal wards under the Act."_/ The Commission concluded that the recommended study was not necessary in light of the industry's substantial reorganization since passage of the Act. _/

Starting as early as the mid 1940's, there have been a number of efforts -- some initiated by the Commission itself -- to transfer administration of the 1935 Act to the Federal Power Commission or, more recently, to the Department of Energy. _/

_/ SEC Comments, supra note ____, at 12.

_/ In evaluating the Commission's comments on its 1977 Report, the GAO concluded that no change in its recommendations had been justified and renewed its recommendation that Congress direct the Commission to make a study of the developments in the gas and electric utility industry under Section 30 of the Act. General Accounting Office, Report to Congress, "The Securities and Exchange Commission's Regulation of Public Utility Holding Companies: An Evaluation of Commission Comments on a Critical Report" (January 4, 1978). Some two and one-half years later, by letter dated November 13, 1980, the Commission reaffirmed its prior comments in response to a letter from Senator Metzenbaum dated July 25, 1980.

_/ The most recent effort was a 1977 proposal to transfer administration of the Act to the new Department of Energy.

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The rationale for transfer was that the Commission's major task of integrating and simplifying the holding company systems had been largely completed and that consolidation of the remaining federal regulation of the gas and electric utility industry in a single agency would eliminate dual control and duplication of effort. These proposals all contemplated retention by the Commission of the same investor protection responsibilities for public utility holding companies that it has with respect to all other publicly-owned companies, including the reporting, proxy, insider trading and tender offer provisions of the Securities Exchange Act of 1934 and the full disclosure and other provisions of the Securities Act of 1933.

All transfer proposals were opposed by the registered systems, which gave as their reason for opposition their view that investor protections would be reduced in order to favor consumers. None, obviously, was successful.

IV. THE COMMISSION'S RECOMMENDATION

There are two primary reasons for the Commission's repeal recommendation. First, the main purpose of the 1935 Act -- reorganization of the nation's electric and retail gas utility holding companies -- has been accomplished. Second, the abuses

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by which holding companies had exploited investors and frustrated effective state regulation of utilities are not likely to recur, for reasons extrinsic to the Act. The bases for the Commission's conclusion that these abuses would not recur are set forth in more detail in this part of the Commission's statement.

A. Investor Protections

It was probably investors who suffered most acutely from the public utility holding company abuses that ultimately resulted in passage of the 1935 Act. The difficulty of obtaining accurate and adequate information was greatly exacerbated by the lack of uniform accounting standards, the absence of which permitted the issuance of securities against arbitrarily written-up asset values or in anticipation of excessive operating profits. As a result, the Act clearly addressed the inability of investors to obtain adequate information regarding holding companies and their subsidiaries.

The 1935 Act addressed this problem by requiring Commission approval before any registered holding company or its subsidiaries could issue most types of securities. That approval must be based on the economic merits of the proposed financing, which must meet certain qualitative standards prescribed in Section 7 of the Act. The Act also authorizes the Commission to require periodic reports from registered holding company systems

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(Section 14), and to prescribe uniform systems of accounts for registered holding company systems and their subsidiaries (Section 15).

As described above, all the 1935-vintage public utility holding companies have long been reorganized and simplified in accordance with the standards of the 1935 Act. It is the Commission's judgment that investors in the remaining registered systems no longer need the special protections of the 1935 Act. These 12 systems now represent only about 20% of the electric industry and 8% of the gas industry. There appears to be no continuing basis for believing that their investors require more protection than investors in exempt holding companies or operating utilities, or, for that matter, in any other industry. This conclusion is based on significant changes that have occurred since 1935 in a number of areas, most notably in the development and extension of the concepts of disclosure and financial reporting under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"), the development of uniform accounting standards, and changes in the investment banking industry.

1. Development of Disclosure and Financial Reporting Standards under the Securities Act and the Exchange Act

While the Securities Act and the Exchange Act (collectively referred to as the "Securities Acts") became law prior to

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passage of the Public Utility Holding Company Act of 1935, the Commission in 1935 was only one year old and had barely begun to carry out its mandate. _/ Since 1935, the concepts of disclosure and financial reporting under the Securities Acts have been greatly developed and expanded. If the 1935 Act were repealed now, investors in public utility holding companies would still have available from other sources essentially the same information called for under the 1935 Act. _/

Several developments have made the disclosure and financial reporting requirements of the 1935 Act redundant. As originally enacted, the Exchange Act required only those companies with securities listed on a national exchange to register those securities with the Commission and to file annual and other periodic reports with the Commission.

_/ Congress also believed that more than disclosure would be required to correct the existing abuses and accordingly directed the Commission to reorganize the industry. As noted, however, reorganization of the industry was completed 20 years ago.

_/ There are some reports required by the Commission under the 1935 Act that are not duplicated in the reports required under the Securities Acts. Reports under the Securities Acts are generally submitted on a consolidated basis. Form U-13-60 under the 1935 Act for service companies in a registered system includes intrasystem transactions with the service company that are eliminated in the consolidation. Two other 1935 Act annual reports, Form U5S and the Rule 2 annual filing for exempt holding companies also break down the consolidated statements into company-by-company statements. These reports are of greater interest to state utility regulators than to investors.

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Similarly, the short-swing insider trading and proxy solicitation provisions of the Exchange Act applied only to companies with listed securities. Initially, many of the public utility holding companies registered under the 1935 Act were not listed on a national exchange and were therefore not subject to these provisions. Disclosure under the 1935 Act became essentially insignificant as the industry was reorganized into integrated operating or holding company systems whose securities were so listed, and completely so in 1964, when the registration requirements of the Exchange Act were expanded to include all companies with more than $1 million in assets and 500 shareholders. _/ All registered holding companies, and most exempt ones, meet these standards. _/

The regulatory system under the Securities Acts has also been extended by Commission rules effectuating statutory provisions, such as those relating to proxy solicitation and antifraud authority, which are not self-executory, as well as by statutory additions to the Commission's authority.

_/ The Commission recently exempted publicy-owned companies with assets of less than $3 million from the registration requirements under the Exchange Act. Securities Exchange Act Release No. 18647 (April 15, 1982), 25 SEC Docket 2080 (April 27, 1982). Even with the higher asset level required, most investor-owned public utility holding companies would still be required to register their securities under the Exchange Act.

_/ Approximately 20 exempt holding company systems are not subject to the Exchange Act registration provisions, mostly because they are substantially privately held.

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The tender offer provisions added to the Exchange Act in 1968 are a significant instance of authority conferred on the Commission to require from nearly all publicly-owned companies disclosures that did not exist when the 1935 Act was passed. Thus, over the nearly 50 years since passage of the Securities Acts, the Commission has developed a comprehensive system of regulation requiring sophisticated financial reporting and full and prompt disclosure of all material information by all public companies, including both registered (and exempt) public utility holding companies.

2. Development of Uniform Accounting Standards

The absence of uniform accounting standards was identified by Congress as a major reason that adequate financial information was not available to investors. _/ The Act accordingly empowers the Commission, in Section 15, to require the keeping of accounts and records using uniform methods prescribed by the Commission. In the judgment of the Commission, changes since 1935 have made this continued authority over the accounting practices of registered systems unneccessary.

Since 1935, extensive accounting and recordkeeping requirements have been developed under the Securities Acts. Section 13(b)(1) of the Exchange Act authorizes the Commission to prescribe accounting methods pursuant to which the financial

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_/ As discussed later, lack of uniform accounting standards also permitted holding companies and their subsidiaries to avoid rate reductions, thereby adversely affecting consumers as well as investors.

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statements of all publicly-held corporations must be prepared. Section 7 of the Securities Act (and Schedule A thereunder) confers similar authority on the Commission for the financial statements included when securities are registered under that Act. The Commission's Regulation S-X establishes the standardized form and content for all registration statements and reports filed pursuant to both Securities Acts. In addition, the Commission has stated its views on a wide variety of accounting and auditing principles in nearly 300 Accounting Series Releases _/ and in Staff Accounting Bulletins where particular issues of financial disclosure warrant more extensive discussion and analysis.

Another significant change since 1935 consists of the uniform systems of accounts established by the Federal Energy Regulatory Commission ("FERC") (formerly the Federal Power Commission) for both electric and gas utility companies operating in interstate commerce. _/ In addition, almost every state has also adopted uniform systems of accounts for electric or retail gas utility companies operating within its jurisdiction. Many of these state uniform systems of accounts are essentially identical to those promulgated by FERC.

Uniform accounting and auditing standards have also been developed by the private accounting profession. The Financial

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_/ These releases were recently codified in "Financial Reporting Release No. 1", Securities Act Release No. 6395 (April 15, 1982), 25 SEC Docket 1962 (April 27, 1982).

_/ 18 C.F.R. pts. 101, 104, 201, and 204.

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Accounting Standards Board ("FASB") has been designated by the accounting profession as the body to establish accounting principles and it has done so in numerous areas. In addition, the American Institute of Certified Public Accountants has established ethical standards for auditors which prohibit them from certifying without exception any financial statements prepared according to accounting principles other than those enunciated by the FASB. _/ The Commission can also take disciplinary action under its Rule 2(e) against auditors who certify inadequate financial statements filed with the Commission.

In recognition of these developments, the Commission in 1975 withdrew the uniform system of accounts previously established for registered holding companies under Section 15 of the 1935 Act. _/ Thus, if the 1935 Act were repealed, investors would continue to have available the type of financial disclosure necessary to evaluate the financial position and earning power of public utility holding companies and their subsidiaries.

3. Changes in the Investment Banking Industry

Changes in the investment banking industry since 1935 also make it unlikely that investor abuses would recur. Prior to passage of the 1935 Act, investment bankers had assumed a dominant role in the management, as well as the financing, of the public utility holding companies and were regarded as

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_/ AICPA Code of Professional Ethics Rule 203, 2 Accountancy L. Rep. ¶ 65,517 (CCH).

_/ 40 Fed. Reg. 22,129 (1975).

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prime culprits in the holding company abuses identified in the Federal Trade Commission and Congressional industry studies. Some of the largest holding company systems had been organized by investment bankers for the purpose of acquiring new clients or protecting existing banking relationships. The National Power Policy Committee, _/ reporting in 1935, stated:

> "Fundamentally, the holding company problem always has been, and still is, as much a problem of regulating investment bankers as a problem of regulating the power industry." _/

As a result of this experience, the Act prohibited investment bankers from serving as officers or directors of registered holding company systems or their subsidiaries, except as the Commission should permit by rule or regulation. In addition, the Act requires prior Commission approval of the fees and other charges associated with underwriting new issues of securities in order to assure that these costs are reasonable.

The investment banking industry itself, however, has changed radically since the 1935 Act was passed. It is subject to a fully established system of regulation and oversight by the Commission under the Exchange Act. _/ Most underwriters also

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_/ This group was an interdepartmental committee appointed by President Roosevelt in 1934 and composed of those persons in the government most concerned with the then-current power problems. The first draft of what is now the 1935 Act was prepared by this Committee in collaboration with leaders in the House and Senate. The Committee's report is appended to S. Rep. No. 621, 74th Cong., 1st Sess. (1935).

_/ Id. at 55.

_/ Cf. infra note ____ (p. 44).

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belong to one of the industry's self-regulatory organizations, such as a national securities exchange or the National Association of Securities Dealers ("NASD"). The NASD has established standards to assure fair and equitable treatment of underwriting clients by member firms. These organizations also have the statutory responsibility under the Exchange Act of imposing and enforcing the requirements of the federal securities laws and the rules promulgated by the Commission thereunder, as well as the rules of the self-regulatory organization itself.

In addition, the concepts of liability to investors under the Securities Acts were essentially undeveloped in 1935. Today, investors who rely on false or misleading statements in purchasing public utility securities may seek relief in private actions against the underwriter. Accordingly, underwriters of new issues customarily perform so-called "due diligence" inquiries to assure that full and accurate disclosure has been made in connection with the offering.

Another change in the private sector is the growth of a sophisticated community of professional financial analysts, often specializing in a particular industry such as electric or gas utilities. Such analysts observe the capital structure of issuers for undue complexity or other evidences of unsoundness. Highly-complex pyramided structures such as those which prevailed in the 1920's in the electric and gas utility industry would be readily detected and would make most and perhaps all of the

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company's securities unmarketable. In addition, securities rating services evaluate the financial reports, business, and structure of issuers before rating its securities. A favorable rating from such a service has become a practical prerequisite to successful marketing of the securities. These developments thus discourage recurrence of the pyramided corporate structure prevalent in the utility industry in the 1920's and help assure that the financial and other disclosures by utility companies are reflected in the market price of their securities.

4. Summary

The Commission is confident that investors in registered public utility companies would remain adequately protected should the Act be repealed. This does not mean, however, that every provision of the 1935 Act is duplicated in other federal regulation. Most notably, Sections 6 and 7 of the Act require prior Commission approval of the issuance of securities based on the Commission's judgment concerning the economic merits of the proposed issuance. No such qualitative review is required by the Commission for the securities of any other publicly-owned company, including utilities in exempt holding companies or operating utilities. The Commission does not believe that this special protection is required any longer for investors in registered public utility holding company systems.

B. Consumer Protections

In contrast to its role under the other statutes within its administration, the Commission's mandate under the 1935 Act

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includes the protection of consumers as well as that of investors. This reflects Congress' view that the abuses in the public utility holding company system permitted the operating utilities to evade effective state regulation and thereby tended to prevent rate reductions. Thus, a second major purpose of the Act was to make it possible for operating utilities to be subject to effective state regulation.

It is important to recognize, however, that the 1935 Act addressed mainly the corporate structure and organization that permitted these abuses to occur. Federal regulation of the rates and service of electric and gas utility operations has always been conferred on a different agency altogether. Protection of consumers through federal regulation of rates, control over interconnection and coordination of facilities, and an "array of other activities in furtherance of [electric] energy capability," _/ has been entrusted to the Federal Power Commission, now the Federal Energy Regulatory Commission. Such regulation has never been the function of the Commission under the 1935 Act. _/ Such regulation commenced in 1920 with the enactment of the Water Power Act, administered by the Federal Power Commission. _/ Enactment of the Federal Power Act in Title II of the Public Utility Act of 1935 greatly expanded the authority of the Federal Power Commission. Three years

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_/ City of Lafayette, Louisiana v. SEC, 454 F.2d 941, 951 (D.C. Cir. 1971).

_/ Id. at 955-56; see also Alabama Electric Coop., Inc. v. SEC, 353 F.2d 905 (D.C. Cir. 1965).

_/ 41 Stat. 1063 (June 10, 1920). Pub. L. No. 280.

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later, the Natural Gas Act of 1938, _/ also administered by the Federal Power Commission, extended federal regulation to the interstate operations of natural gas pipelines.

A number of utility holding company characteristics frustrated effective state regulation prior to passage of the Act. One device frequently used by holding company systems to inflate operating expenses or asset values to the detriment of the consumer involved contracts for management, construction, or supplies between the operating utility and another company within the same system. While these contracts were frequently performed at inflated costs to the utility, state regulators did not have access to the books and records of an out-of-state affiliate to disprove their reasonableness. Lack of uniform accounting standards also led to the inclusion of abritrarily written-up asset values in the rate base. Also, the far-flung utility holding company empires effectively removed control of the operating utilities from the kind of local management Congress deemed most sensitive and responsive to local needs and concerns with respect to the operating utilities, given their essentially local nature at that time.

The Commission does not believe that the holding company abuses which frustrated effective state regulation or otherwise adversely affected consumers will recur. In part, the Commission's conclusion is based on the extensive reorganization of the industry which occurred under Section 11. However, it is also based on the tremendous increase since 1935 in the

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_/ 15 U.S.C. 717 et seq.

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effective regulation of electric and gas utilities at both the federal and the state level.

1. Federal Regulation of Electric and Gas Utilities

. The Federal Power Act and the Natural Gas Act, both administered by the Federal Energy Regulatory Commission, establish comprehensive schemes for federal regulation of all aspects of the interstate transmission and sale of electrical energy and natural gas, respectively. FERC is charged in administering these Acts with assuring maximum supply and continuity of utility service, as well as "just and reasonable rates" for wholesale sales of electric energy and gas. _/ In addition to wholesale rate regulation, these Acts provide for regulation of the construction, acquisition, or disposition of utility properties, the issuance of securities (where not subject to regulation at the state level), and affiliate transactions. FERC has established uniform systems of accounts under both Acts and is also authorized to require detailed information regarding utility finances and corporate structure to assure effective implementation of the Acts' substantive provisions. Provisions throughout both Acts require that regulatory determinations be made "in the public interest," which in this context would focus on the interests of energy consumers._/

_/ 16 U.S.C. 824d(a) and 15 U.S.C. 717c(a).

_/ See 15 U.S.C. 717(a); 16 U.S.C. 824(a); NAACP v. FPC, 425 U.S. 662, 666, 669-70 (1976).

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Finally, both Acts provide for coordination and cooperation of federal regulatory efforts with those of the states.

Section 6 of the Natural Gas Act _/ and Section 208 of the Federal Power Act, _/ which are identical, authorize FERC to ascertain the cost of the property of every natural gas pipeline company or electric company subject to its jurisdiction, the depreciation associated with such property, and, when necessary for ratemaking purposes, other facts which bear on the determination of such cost or depreciation. FERC uses this authority to regulate transactions between such utilities and affiliated entities. It might be noted that FERC recently determined that it would be more appropriate to use a market test as the basis for determining the reasonableness of an affiliate supplier's price._/ Section 13 of the 1935 Act requires use of a "cost" standard in such transactions. Section 318 of the Federal Power Act _/ provides for deference to the Commission's jurisdiction under the 1935 Act when the 1935 Act and the Federal Power Act contain overlapping provisions. Thus, that portion of the industry represented by the registered holding company systems is now subject to a different federal standard for determining

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_/ 15 U.S.C. 717e.

_/ 16 U.S.C. 824g.

_/ Public Service Company of New Mexico, 10 FERC (DOE) ¶ 63,020 (Jan. 25, 1980). See Columbia Gulf Transmission Company, Dkt. No. RP75-105, Op. No. 47 (July 2, 1979), reh. denied, Op. No. 47-A (Dec. 20, 1979).

_/ 16 U.S.C. 825q.

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affiliate transaction prices than that applied to the rest of the industry. Repeal of the 1935 Act would eliminate this difference. _/

2. State Regulation of Electric and Gas Utilities

Another factor in the Commission's decision to recommend repeal of the 1935 Act is the significant increase since 1935 in the effective reach of state utility regulation. One of the reasons underlying Congressional concern with the vast public utility holding companies of the 1920's and early 1930's was that their interstate activities were not susceptible to effective control by state regulators. The Commission recognizes that the states are still unable to regulate interstate utility holding companies directly in a comprehensive fashion, and that the pattern of state control over operating

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_/ There is no comparable provision in the Natural Gas Act which regulates the interstate gas pipelines. It should be noted that Section 305(b) of the Federal Power Act prohibits, unless authorized by order of the Federal Energy Regulatory Commission, officers and directors of a public utility from serving as officers and directors of banks, investment bankers, underwriters, and electrical equipment suppliers. In addition section 305(c) of that statute requires annual reporting of such interlocks, and defines certain terms (holding company, registered holding company and holding company system) by adopting their definitions in the 1935 Act. If the 1935 Act is repealed, these terms will have to be formally defined in the Federal Power Act.

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utilities and their relationships with affiliates _/ remains uneven. However, state commissions today generally have far more practical experience and better resources with which to supervise public utilities than was the case in 1935.

A major factor in more effective regulation is the dramatic development of uniform and enforceable accounting standards noted above. Uniform accounting standards give state regulators a far more accurate, sophisticated, and useful understanding of intercorporate transactions, utility earnings, and investment and capital needs, than did the accounting standards that existed at the time the 1935 Act became law.

Another factor that has enhanced the effectiveness of state regulation is the historical role of the 1935 Act in restructuring the industry. The Commission has successfully dismantled the former complex utility conglomerates into the present integrated utility systems with simple capital structures, most of which are now either operating companies or exempt holding companies. This simplification has permitted the states to exercise greater control over utility companies operating within their jurisdiction.

_/ In this section, the term "affiliate" is used in the ordinary sense of the word to mean a person or another company that has a significant relationship with the utility, usually through stock ownership, either directly or through a common parent company. The 1935 Act and state utility codes variously define the term.

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The effective reach of state utility regulation has also considerably expanded as a result of judicial decisions handed down shortly before or after the 1935 Act became law. One was the 1932 Supreme Court decision in Western Distributing Co. v. Public Service Commission, 285 U.S. 119, in which the Court abolished the prior general rule that state regulators had the burden of disproving the reasonableness of contracts between a utility and its parent. Since that time, the state commissions have been able to require that utilities demonstrate the reasonableness of contractual and other operating and service costs, particularly when performed by affiliates. Another was the Supreme Court's 1937 decision in Natural Gas Pipeline Company v. Slattery, 302 U.S. 300, which upheld the authority of state regulators both to require access to the accounts and records of an affiliate that had engaged in transactions with a jurisdictional utility _/ and to require the submission of any necessary reports from the affiliate.

Thus, although states may not exercise direct regulatory powers over foreign utility holding companies, they are generally able to regulate the various relations and dealings between operating utility companies, their parent holding companies,

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_/ A utility company within the regulatory jurisdiction of a particular state public service commission is commonly known as a "jurisdictional utility."

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and other affiliates. Following are some examples of state legislation which empower public service commissions to exercise such control.

a. Accounting and Reporting Requirements

Today, almost every state has adopted legislation requiring electric and gas utility companies to use a uniform system of accounts and prescribing or authorizing the state public service commission to prescribe applicable methods. _/ State law may also provide that utilities must keep separate accounts for non-utility businesses in which they engage and furnish those accounts to the state agency. _/ Many states also have special accounting and reporting requirements for transactions between the utility and affiliates. _/ In addition, they may require annual and other financial reports to disclose relationships with affiliates and business operations of the affiliates, _/ or the identity of corporate stockholders, and their officers and directors. _/ State utility commissions may also be

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_/ See, e.g., Ill Ann. Stat. Ch. 111 2/3 § 11 (Smith-Hurd 1977). The 1980 Annual Report of the National Association of Regulatory Utility Commissioners (hereinafter "NARUC 1980 Report") indicates that only Nebraska has no such authority. In practice, many states have adopted the FERC system of uniform accounts.

_/ See, e.g., D.C. Code Ann. § 43-509 (1981).

_/ NARUC 1980 Report at 525.

_/ See, e.g., Md. Ann. Code, Art. 78 §§ 67B, 67C.

_/ See, e.g., Ind. Code Ann. § 8-1-2-49(3) (Burns 1973).

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authorized to require annual audits by independent accountants and/or to conduct such audits themselves. Some state agencies may even perform limited inspections of affiliate records._/

b. Prior approval of transactions with affiliates

In recognition of the possible unfairness involved when public utilities enter into business dealings with affiliates, states typically require prior approval of contracts with affiliates for supplies, management services, or construction. _/ In addition, prior state commission approval may be required for any loans _/ or financial contracts _/ between a public utility company and its affiliates. _/

State public service commissions also regulate transactions between the utility and its affiliates indirectly through their ratemaking authority. For example, state laws may control or

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_/ See, e.g., Mass. Ann. Laws, ch. 164 § 85 (Michie/Law. Co-op. 1979).

_/ See, e.g., 66 Pa. Cons. Stat. Ann. § 2102 (Purdon 1979) (West).

_/ See, e.g., N.J. Stat. Ann. § 48:3-7.2 (West 1969).

_/ See, e.g., Ill. Ann. Stat., Ch. 111 2/3 § 8a(3) (Smith-Hurd 1977).

_/ For that matter, the revenues from public utility operations may be restricted by state law to specified uses, all related to public utility operations. See, e.g., N. Y. Pub. Ser. Law § 107 (McKinney 1955).

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limit borrowing by the utility from affiliates by limiting the inclusion of such interest expenses in the cost of service to those found to be "reasonable."_/ The commissions may disallow as a cost of service or from the rate base a portion of the amounts charged a utility in transactions with affiliates if the amount is either found to be above market cost, involves a rate of return to the affiliate deemed excessive, or is otherwise deemed unreasonable. State commissions may also allocate costs between an operating company and its affiliates._/

c. Financings and Capitalization

The issuance of securities by public utilities, including mortgage bonds, debentures, notes (over one year in maturity) and preferred and common stock, is now specifically regulated in most states. _/ Often the proceeds from the issuance of stock or debt are restricted to certain purposes related to utility operations and the amount of each issue is approved by the state commission. _/

_/ See, e.g., Texas Rev. Civ. Stat., Art. 1446c, § 41(c)(1) (Vernon 1980).

_/ See, e.g., N.Y. Pub. Ser. Law § 66(13) (McKinney 1955).

_/ NARUC 1980 Report at 520.

_/ See, e.g., Mich. Stat. Ann. § 22.101 (Callaghan 1970).

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Irrespective of involvement by an affiliate, many states require express prior approval from the state regulatory commissions for any loan, guarantee or endorsement of indebtedness, or investment of funds by jurisdictional utilities, to assure that the operating utility is protected from any abusive lending or credit relationship. _/ States may also require prior regulatory approval for any sale, assignment, transfer, lease, mortgage, or other direct or indirect disposition or encumbrance of public utility property, franchises, or business._/

The utility's capitalization may be protected in part by restrictions concerning the payment of dividends by the utility. _/ The integrity of a utility's stated and actual capital may be also preserved by limitations on the capitalization of intangible assets, _/ the periodic revaluation of capital assets, _/ and requirements that capital impairments be made good. _/

_/ See, e.g., Mass. Ann. Laws, ch. 164, § 17A (Michie/Law. Co-op. 1979).

_/ See, e.g., Cal. Pub. Util. Code § 851 (West 1975).

_/ See, e.g., N.J. Stat. Ann. § 48: 2-29-1 (West 1969).

_/ See, e.g., Cal. Pub. Util. Code § 820 (West 1975).

_/ See, e.g., Ill. Ann. Stat., ch. 111 2/3 § 30 Smith-Hurd (1977).

_/ See, e.g., Mass. Ann. Laws, ch. 164 § 16 (Michie/Law. Coop. 1979).

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d. Review of Major Corporate Changes

State utility commissions may be authorized to conduct advance reviews of mergers, reorganizations, or consolidations, _/ as well as of changes in control. _/ This type of state regulation conditions major corporate changes on prior state approval. Special examination of a public utility's capitalization may be required on such occasion to assure that fair value is paid for the company's stock and assets. _/

e. Conclusion

The Commission recognizes that not all states have in place comprehensive systems of utility regulation that include all of the above items. However, it seems clear that the states have the authority to enact such systems and it seems equally clear that a comprehensive state system is fully able to protect the financial integrity of a public utility operating within its jurisdiction to assure that neither utility revenues (other than reasonable and proper dividends), utility assets, or utility credit are used for non-utility purposes except in accordance with prescribed guidelines or following review and approval by the state regulators. The states also appear to have adequate authority to regulate transactions between the utility and its affiliates to prevent the type of overreaching

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_/ See, e.g., Mass. Ann. Laws, ch. 164 §§ 96, 97 (Michie/Law. Co-op. 1979 & 1981 Supp.); N.Y. Pub. Serv. Law §69-a (McKinney 1955).

_/ See, e.g., Cal. Pub. Util. Code § 854 (West 1975).

_/ See, e.g., N.Y. Pub. Serv. Law § 69-a (McKinney 1955).

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that characterized so many holding company systems prior to 1935.

These transactions are already regulated at the state level for operating companies and exempt holding companies without the additional substantive regulation under the 1935 Act. While the state regulators probably would not be able to exercise the same type of direct regulation of an out-of-state parent holding company that the Commission does under the 1935 Act, the Commission believes that state regulation nonetheless could assure continued protection of consumers through comprehensive regulatory authority over the operating utilities and their transactions with affiliated entities.

V. THE 1935 ACT AND DIVERSIFICATION

The Commission is aware that a primary reason for much industry support for amendment or repeal of the 1935 Act is the interest many utilities have in using a holding company structure to diversify into non-utility businesses. The Act places some limits on such diversification through a holding company structure, and there is no other federal law that directly duplicates these restrictions. Potential elimination of such restrictions has caused some opponents of amendment or repeal of the Act to charge that such action would allow public utilities to reorganize into holding companies and thereby "escape" state regulation of diversification.

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The Commission is sensitive to concerns that diversification might injure consumers or investors. Nevertheless, while the precise effects of diversification cannot be anticipated, partly because diversified activities vary greatly in magnitude and type, successful examples of highly diversified companies provide support for the industry's position. One such company is Citizens Utilities Co. which supplies electric, gas, telephone, water and wastewater services in more than 500 communities across the United States. Another example is General Telephone & Electronics Corp. which, aside from its telephone operations, markets many different telecommunications products. Tenneco Inc. is another successfully diversified company dealing in natural gas, petrochemicals, construction and farm equipment, and shipbuilding. Tenneco also has interests in insurance and banking.

The 1935 Act does not, of course, impose any restrictions or limitations on investment in non-utility businesses by operating electric or retail gas utilities that are not part of any holding company systems. Nor does the Act impose any limitations whatsoever on diversification by gas pipeline companies unless they are part of a system registered or exempt under the 1935 Act.

Diversification outside the utility industry was not a major concern when the 1935 Act was passed. Divestiture of unrelated businesses and the requirement of prior Commission approval for the acquisition of new non-utility interests by a registered

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system was rather a necessary adjunct to the Commission's primary mandate of reorganizing and simplifying the industry. Limitations on non-utility business activity by registered systems also reflected the prevalent view that the inherent stability, security, and profitability of the gas and electric industry was so great that almost any other type of investment was speculative by comparison and could only harm investors and consumers.

The utility business has changed significantly since that time and is now experiencing serious financial difficulties. The Commission is not in a position either to endorse or refute the industry's arguments that non-utility diversification is essential to its future financial health. Even if Congress should decide, however, that diversification is undesirable, the Commission does not believe it is necessary or desirable to retain the 1935 Act's detailed and comprehensive regulatory structure simply because it now serves to restrict the non-utility activities of holding companies.

This section of the Commission's statement explains the extent to which non-utility diversification is permitted under the Act by both registered and exempt holding companies, identifies the reasons limitations on such diversification were originally included in the Act, and summarizes the reasons why such concerns do not appear to justify continued retention of the Act's regulatory structure.

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A. Limitations on Holding Company Diversification under the 1935 Act

The 1935 Act unquestionably limits the ability of both registered and exempt holding companies to diversify into non-utility businesses, although the restrictions are much more stringent for registered systems.

Section 11 of the Act requires that non-utility businesses of registered systems to be limited to those which are "reasonably incidental, or economically necessary or appropriate to the operations of [an] integrated public utility system." This requirement is often referred to as the "functional relationship" test. _/ Section 11 further requires that the Commission find that retention of an interest in a non-utility business be "necessary and appropriate in the public interest or for the protection of investors or consumers and not detrimental to the functioning of such system or systems." The Commission is authorized to require that registered systems divest any non-utility businesses that fail to meet the "functional relationship" standard of Section 11.

Sections 9 and 10 of the Act apply to new acquisitions by registered systems and require prior Commission approval of all such transactions. Because Section 10 prohibits Commission approval of any acquisitions deemed detrimental to the carrying out of the provisions of Section 11, new acquisitions of non-utility businesses are precluded unless they meet the "functional relationship" test.

_/ See Michigan Consolidated Gas Co. v. SEC, 444 F.2d 913, 917 (D.C. Cir. 1971).

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Although the restrictions on non-utility businesses in Section 11 and Sections 9 and 10 apply only to registered systems, those provisions raise questions as to the extent to which exempt holding companies can diversify into non-utility businesses without losing their exemptions through Commission action under the "unless and except" clause of Section 3. _/

In two cases decided together in 1973, _/ a four-member Commission agreed that the Section 11 restrictions on non-utility investments did not apply to exempt holding companies but also concluded that the "unless and except" clause placed some limits on diversification by those companies. In those decisions, Commissioners Owens and Herlong would have required restrictions very close to those imposed on registered systems, thus requiring divestiture of interests such as agriculture and real estate, as well as finance and leasing activities. Chairman Casey and Commissioner Loomis would have permitted retention of unrelated investments subject to the following five guidelines:

1. Non-utility activities must be separated from utility activites in separate corporate subsidiaries.

2. No service, materials, or other contracts are permitted between the utility and the other subsidiaries unless subject to supervision by state regulators.

_/ If the Commission revoked or denied their exemptions, such holding companies would be required to register and then could be required under Section 11 to divest themselves of those businesses or properties had no "functional relationship" to their utility operations.

_/ In Re Pacific Lighting Corp., 45 SEC 152 (1973) and In Re National Utilities & Industries Corp., 45 SEC 167 (1973).

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3. No use of utility operating management, funds or credit is permitted for non-utility purposes.

4. Non-utility investments, both individually and in the aggregate, must be a relatively small part of the system.

5. Non-utility businesses must either significantly complement the utility business or have established and successful records.

Chairman Casey and Commissioner Loomis concluded that the non-utility investments in these cases conformed to these guidelines and would have permitted the companies to retain their exemptions. The effect of the 2-2 split was to permit the existing exemptions to continue.

Although the Commission has not revisited this issue since 1973, it has not sought to revoke or deny any Section 3(a) exemptions on the grounds of non-utility investments. While the Commission continues to believe that it has the authority to take such action, such issues would generally not be raised unless the non-utility investments either posed a threat to the financial integrity of the utility system or resulted in a system that was no longer primarily in the utility business. _/

In administering the Act's provisions relating to the retention or acquisition of "functionally related" non-utility businesses, the Commission has determined that acquisitions related to the utility's fuel supply -- such as coal mines for electric utilities, oil and gas exploration ventures, and fuel

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_/ See In Re Lykes Bros. Inc., Public Utility Holding Company Act of 1935 Release No. 20483 (April 6, 1978), 14 SEC Docket 672 (April 18, 1978).

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transportation facilities -- satisfy the statutory standards. Such acquisitions, however, must be primarily for the use of the system's utility operations and not for sale to others. Areas found by the Commission not to meet the "functional relationship" test have included land development, housing construction, electric instruments, pulpwood, textiles, buses, street railways, as well as ice and telephone companies.

B. Role of Non-Utility Diversification in Passage of the 1935 Act

Because no other federal statute directly duplicates the restrictions on non-utility investments imposed by the 1935 Act, the Commission has sought to identify why such limitations were included by Congress.

As noted, passage of the 1935 Act was preceded by an exhaustive Federal Trade Commission study _/ of the public utility industry that has been referred to as "the most thoroughgoing investigation of an American industry that has ever appeared." _/ The House Interstate and Foreign Commerce Committee also conducted a separate investigation, resulting in a 6-volume report. _/ The Supreme Court has referred to these two reports as "some of the most exhaustive and comprehensive studies ever to underlie a federal statute." _/ Both clearly identified

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_/ FTC Report, supra note ___.

_/ Barnes, supra note __ at 71 n.8.

_/ Splawn Report, supra note ___.

_/ North American Company v. SEC, 327 U.S. 686, 701 n.11 (1946).

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numerous and complex abuses attributable to the aggregation of control of electric and gas utilities in vast holding company systems. However, while the acquisition of non-utility businesses by such systems was noted, it was not linked to any abuses other than those arising out of utility transactions with affiliates. The term "diversification" as used in these reports refers to the alleged diversification of risk obtained when holding companies owned geographically scattered and unintegrated utility properties -- not to utility holding company acquisitions of non-utility businesses.

Nonetheless, the 1935 Act expressly limits registered holding company systems to non-utility businesses that are functionally related to the operations of an integrated public utility system. Concern over such investments is found in other portions of the Act's legislative history. For example, in its report to the Congress, the National Power Policy Committee _/ stated:

> "Holding companies should be restricted as soon as practicable to the business of operating and owning the securities of public-utility properties; they should not be permitted to engage in nonutility or speculative ventures." _/

There appear to be two reasons for this point of view and for the Act's limitations in Section 11 on retention of non-

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_/ See supra note __ (p. 37).

_/ S. Rep. No. 621, 74th Cong., 1st Sess. 59 (1935).

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utility investments by registered holding company systems. First, elimination of many non-utility holdings was necessary to achieve the overriding purpose of the Act -- reorganization of the holding company empires to reduce utility systems to a size that corresponded to the essentially local nature of gas and electric utilities at that time and that would permit effective regulation of utility operations at the state level. As stated in the Senate Report, one of the purposes of Section 11 was

> "to confine the operations and the interest of each public utility system to the actual utility business of a given region so that the system will have to work out a modus vivendi with the population of that region." _/

Restoration of utility operations to local control and management was facilitated by the requirement that the parent holding company limit its interests in non-utility businesses to those related to that integrated utility system.

Second, commentary on non-utility investments in the Act's legislative history invariably refers to the speculative nature of such investments. The most significant instance where utility and non-utility operations were combined was in the Cities Service holding company system. _/ That system controlled some 65 public utility companies in 20 states and Canada, plus some 45 additional companies that were engaged in

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_/ S. Rep. No. 621, 74th Cong., 1st Sess. 11 (1935).

_/ In Re Cities Service Co., 8 SEC 318 (1940).

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the oil business. Oil production was then regarded as highly speculative, in sharp contrast to the security, stability, and profitability of the gas and electric utility business. It was felt that investors who thought they were buying utility securities in such cases would be seriously misled as to the true character of their investment and its inherent risks. Furthermore, it was thought that the more speculative nature of non-utility businesses meant that investors could only be injured -- never benefited -- by such investments. _/ The resultant injury to the utility's credit could only cause the costs of capital to increase, thereby also injuring the consumer through higher rates.

C. Changes in the Industry

These views were all premised on a highly stable and profitable electric and retail gas utility industry. This was an accurate description until relatively recently. Even in 1972, the National Association of Regulatory Utility Commissioners could report with respect to electric utilities:

> "[T]here is no problem of a slackening in demand for electric service or the emergence of significant competitors of the existing electric power industry. Indeed, the converse is the case. Demand is growing more rapidly than the capacity of the industry to supply it, and more uses for electricity are being uncovered each day.... Considering trends in

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_/ Hearings before the Securities Subcommittee of the Committee on Interstate and Foreign Commerce, "Study of Operations Pursuant to the Public Utility Holding Company Act of 1935," 79th Cong., 2d Sess. 948-49 (1946) (testimony of Milton Cohen).

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> demand, costs, technology and competition, it is safe to conclude that for the indefinite future the electric power industry, in substantially its present form, will continue to be a vital and growing industry...."_/

The financial situation of the industry has changed dramatically since that report. Inflation, the high cost of fuel, overcapacity, and a declining growth rate have created financial problems for the utilities. Rates have moved steadily upward, but most utilities are still not earning their allowed rates of return. Bonds have been downrated and the common stocks of most utilities have been selling below book value for some time. These factors indicate that utilities are not now the stable and profitable investment that they were in 1935 or even 10 years ago. Thus, the argument that any move by a utility into another business necessarily increases the risk of the total enterprise no longer has the same validity. In contrast today, there seems to be a good chance that the new business may prove less "risky" or more profitable than the utility. In any event, the financial reporting and disclosure requirements of the Securities Acts should assure that investors have every opportunity to determine accurately the type of business engaged in by the companies that offer securities to the public.

_/ 1972 Report of the Ad Hoc Committee on Non-Utility Investments - Diversification by Utility Companies, National Association of Regulatory Utility Commissioners, at 10.

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For these reasons, the Commission does not believe it appropriate to retain the 1935 Act merely for the purpose of inhibiting or restricting non-utility investments by utility holding companies or because the Act may deter take-overs of utilities by conglomerates. Neither of these concerns was central to Congress' thinking when the Act was passed in 1935. They do not justify retention of a statute that imposes continuing substantive regulatory burdens on a relatively small portion of the industry long after its basic purpose has been accomplished and the abuses which the Act was intended to correct have been eradicated.

V. CONCLUSION

For the foregoing reasons -- the completion of the Commission's basic task under the Act and significant changes since 1935 in the economic and regulatory climate affecting electric and retail gas utilities -- the Commission recommends that Congress repeal the 1935 Act.

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APPENDIX A

OUTLINE OF MAJOR PROVISIONS OF PENDING BILLS
TO AMEND
THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

S. 1871: This bill would amend the definition of the term "public utility company" in Section 2(a)(5) to exclude gas companies that either own or operate only facilities for the retail distribution of gas within a single state or whose interstate rates are subject to regulation by the authorities of one state or of contiguous states. The proposal would make this exception available only if every company that controlled, directly or indirectly, the gas utility company had a class of securities registered under the Securities Exchange Act of 1934 and was thus subject to the financial reporting and other provisions of that Act. The three currently registered gas utility holding companies meet these standards and thus would be removed from the Act's jurisdiction if this bill were enacted.

S. 1878 and H.R. 5220: These two bills would both amend Section 3 of the 1935 Act to entitle two additional categories of holding companies to exemption. More significantly, these proposals would require the Commission to grant unqualified exemptions from all provisions of the Act, other than Section 9(a)(2) (which concerns acquisitions where the acquirer is or would become an an affiliate of more than one electric or retail gas public utility company). This would be accomplished

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by eliminating "unless and except" clause in the present statute that permits the Commission to revoke or deny an exemption if it is detrimental to the public interest or to the interests of investors or consumers. This would effectively repeal the 1935 Act for any holding company meeting the current or proposed standards for exemption. H.R. 5220 would also add a new subsection (f) to Section 3 to require that any non-utility business of a holding company exempt under Section 3(a) be conducted through a separate non-utility subsidiary.

S. 1869: This bill would make major amendments in the provisions of the Act relating to financings, non-utility acquisitions, retention of gas utility properties, and affiliate transactions. Some of the most significant changes include:

- Elimination of Commission jurisdiction over most financings and alteration of the standards for approving the financings that remain under Commission jurisdiction. The proposed changes include permitting filings for financings to become effective automatically unless affirmative action is taken by the Commission and providing that any such action be based on an "unsound financial practice," a new term defined in S.1869. These changes would constitute a considerable circumscription of the current qualitative standards for approving financings by registered public utility holding company systems.

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- Elimination of the current requirement for prior Commission approval of the acquisition of non-utility businesses and alteration of the standards pursuant to which divestiture of such businesses could be required. Under this proposal, the Commission could require divestiture where both the non-utility business was found to be "material" and its continued retention found detrimental to investors or consumers. As a practical matter, the Commission might be able to force divestiture under these standards only if the business were relatively large and losing money and the utility system faced a financial crisis.
- Ability of three of the registered electric systems to retain their relatively minor gas operations would be assured.
- Elimination of Commission regulatory authority over a number of transactions between companies within the same registered system where the transactions are expressly authorized by the relevant state commission.
- Alteration of the present "cost" standard for contracts with affiliates to permit performance at a price equal to or less than the market price of comparable goods or services.

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APPENDIX B

SECTION BY SECTION ANALYSIS OF
THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

NECESSITY FOR CONTROL OF HOLDING COMPANIES

Section 1

Section 1 recites the need to control public-utility holding companies, lists a group of evils and abuses that adversely affected the national public interest, the interest of investors and the interest of consumers, and declares that the act's policy shall be "to meet the problems and eliminate the evils as enumerated in this section."

DEFINITIONS

Section 2

Section 2(a) sets forth the definitions under the act. Section 2(b) contains provisions for declaring a "person," rather than a "company," to be a holding company, subsidiary company or an affiliate under the act. Section 2(c) provides that the act shall not apply to Federal or state agencies, authorities, corporations or instrumentalities. The more important of the definitions are as follows:

"Holding company," defined in section 2(a)(7)(A) as one "which directly or indirectly owns, controls or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company;"

"Public-utility company," defined in section 2(a)(5) as "an electric utility company or a gas utility company;"

"Electric utility company," defined in section 2(a)(3) as one "which owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale;"

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"Gas utility company," defined in section 2(a)(4) as one "which owns or operates facilities used for the distribution at retail . . . of natural or manufactured gas for heat, light and power;"

"Utility assets," defined in section 2(a)(18) as "the facilities, in place, of any electric utility company or gas utility company for the production, transmission, transportation, or distribution of electric energy or natural or manufactured gas;" and

"Integrated public-utility system," defined in section 2(a)(29)(A) for an electric system and in section 2(a)(29)(B) for a gas system, both such definitions being concerned with the physical interconnection and coordinated operation of utility properties in a single area or region.

EXEMPTIONS

Section 3

Section 3(a) of the act provides that the Commission shall exempt certain specified types of holding company systems from the act "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers." This is known as the "unless and except" clause. The types of holding companies which qualify for this exemption are:

(1) the predominantly intrastate holding company system, where the holding company and all its public utility subsidiaries are all organized and carry on their business in substantially one state;

(2) the system whose holding company is predominantly an operating public-utility company whose utility operations do not extend beyond the state in which it is organized and states contiguous thereto;

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(3) the company which is only incidentally a holding company, being primarily engaged in another business;

(4) the temporary holding company, which has become such through the acquisition of securities for liquidation or distribution in connection with a debt or arrangement for underwriting or distributing the securities; and

(5) the holding company with no domestic public-utility subsidiaries.

Section 3(b) concerns exemptions from the act for certain foreign subsidiaries of a holding company. Section 3(c) provides that the Commission shall revoke an exemptive order issued under section 3(a) or 3(b) when it "finds that the circumstances which gave rise to the issuance of such order no longer exist." Section 3(d) provides that the Commission may by rule exempt from some or all provisions of the act, conditionally or unconditionally, any class or classes of persons from the duties and obligations imposed upon them as subsidiary companies or affiliates.

TRANSACTIONS BY UNREGISTERED HOLDING COMPANIES AND REGISTRATION OF HOLDING COMPANIES

Sections 4 and 5

Section 5 provides for the registration of holding companies under the act. Unless a holding company applies for an exemption pursuant to section 3(a), or registers under section 5(a), then section 4(a) makes it unlawful for such holding company, directly or indirectly, to engage in various activities in interstate commerce, including owning securities of a subsidiary that is engaged in such activities.

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FINANCINGS

Section 6

Section 6(a) provides that unless the Commission permits a declaration to become effective under section 7, it shall be unlawful for any registered holding company or subsidiary thereof to (a) issue or sell any security of such company, or (b) exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of such company. Section 6(b) provides certain exemptions from the provisions of section 6(a). Among such exemptions is one for the issuance and sale of short-term debt (not to exceed 5% of the issuer's capitalization), and another under which the Commission shall exempt, subject to such terms and conditions as it deems appropriate, the issuance and sale of securities by a subsidiary of a registered holding company if the purpose is solely for financing the business of the subsidiary and it has been expressly authorized by the State commission of the State in which such subsidiary is organized and doing business.

Section 6(c) makes it unlawful for a registered holding company or subsidiary thereof, directly or indirectly, to (1) engage in house-to-house sales of any security of the holding company, or (2) have any officer or employee of any subsidiary of such holding company sell any security of the holding company.

Section 7

Section 7 contains the standards for the issue or sale of a security by a registered holding company or subsidiary thereof. Generally, the security must be either --

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(a) a common stock having a par value and being without preference as to dividends over, and having at least equal voting rights with, any outstanding security of the issuer; or

(b) a bond secured by a first lien on the physical property of the issuer; or

(c) a guaranty of, or assumption of liability on, a security of another company; or

(d) is to be issued or sold solely for the purpose of refunding a security of the issuer or for the purpose of effecting a merger, consolidation, or other reorganization; or

(e) is to be issued or sold solely for the purpose of financing the business of the issuer as a public-utility company; or

(f) is to be issued or sold solely for the purpose of financing the business of the issuer when it is neither a holding company nor a public-utility company; or

(g) is to be issued or sold for necessary and urgent corporate purposes of the issuer when the requirements of issuing a common stock or first lien mortgage bond would impose an unreasonable financial burden on the issuer.

In addition, under section 7(d) the Commission may not permit the issue of sale of a security if it finds that:

(a) the security is not reasonably adapted to the security structure of the issuer and other companies in the same holding company system; or

(b) the security is not reasonably adapted to the earning power of the issuer; or

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(c) the financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operations of a business in which the issuer lawfully is engaged or has an interest; or

(d) the fees and commissions with respect to such issue or sale are not reasonable; or

(e) with respect to a security that is a guaranty of a security of another company, the circumstances are such as to constitute the making of such guaranty an improper risk; or

(f) the terms and conditions of the issue and sale of the security are detrimental to the public interest or the interest of investors or consumers.

In addition, section 7(g) provides that applicable state laws must also be complied with.

COMBINATION GAS AND ELECTRIC COMPANIES UNDER STATE LAW

Section 8

Section 8 is concerned with the impact of state laws (dealing with the combined operation within the same area of electric and gas utilities by a single company or companies owned by one company) on acquisitions by registered holding companies and their subsidiaries of interests in electric and gas utilities. It makes it unlawful, if state law prohibits or requires approval or authorization of combination gas and electric utility companies, for a registered holding company or subsidiary thereof (1) to take any step resulting in its having an interest in a gas utility company and an electric utility company serving substantially the same territory without state approval, or (2) if it already has such an interest, to acquire

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an interest in either a gas or electric utility serving substantially the same area as that served by the such companies in which it already has an interest without state approval.

ACQUISITIONS

Section 9

Section 9(a) provides that unless the acquisition has been approved by the Commission under section 10, it shall be unlawful --

(1) for any registered holding company or subsidiary thereof to acquire, directly or indirectly, any securities or utility assets or any other interest in any business;

(2) for any person to acquire, directly or indirectly, any security of a public-utility company, if he is an affiliate under section 2(a)(11)(A) of such company and any other public-utility or holding company, or will as a result of the acquisition become such an affiliate. Section 2(a)(11)(A) defines an affiliate of a specified company as "any person that directly or indirectly owns, controls, or holds with power to vote, 5 per centum or more of the outstanding voting securities of such specified company."

Section 9(b) provides two exemptions from the requirements of section 9(a). The first exempts an acquisition by a public-utility company of utility assets the acquisition of which has been expressly authorized by a State commission. The second exempts an acquisitions by a public-utility company of securities of its subsidiary public-utility company provided both companies are organized in the same State, the business of each is substantially confined to such State, and the acquisition has been expressly authorized by the State commission of such State.

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Section 9(c) exempts from the requirements of section 9(a) the acquisition by a registered holding company or subsidiary thereof of (1) securities issued or securities guaranteed by the United States or a State, or related entities, (2) certain other securities, primarily short-term obligations, that the Commission may by rule or regulation prescribe as appropriate and as not detrimental to the public interest or the interest of investors and consumers.

Section 10

Section 10 contains the standards which must be found by the Commission before it may grant an application (1) under section 9(a)(1) by a registered holding company or subsidiary thereof with respect to the acquisition of securities, utility assets, or any other interest in any business, and (2) under section 9(a)(2) by any person to acquire public-utility securities when such person is or will become an affiliate of the company whose securities are acquired and of any other public-utility or holding company.

Section 10(a) sets forth the kinds of information required in the application, and Section 10(d) prescribes the procedures for processing the application. Section 10(b) provides that the Commission may not grant an application if it finds that --

(a) the acquisition will tend toward interlocking relationships or concentration of control of publicl-utility companies of a kind or to an extent detrimental to the public interest or the interest of investors or consumers; or

(b) the consideration, including all fees, commissions, and other renumeration is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the

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utility assets to be acquired or the utility assets underlying the securities to be acquired; or

(c) the acquisition will unduly complicate the capital structure of the holding company system or be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system.

Section 10(c) provides that the Commission shall not approve--

(a) an acquisition of securities, utility assets or any other interest which is detrimental to the carrying out of the provisions of section 11 (which concerns the simplification of holding company systems), or would evade state limitations on combination electric and gas service; or

(b) the acquisition of securities or utility assets of a public-utility or holding company unless it finds the acquisition will serve the public interest by tending toward the economical and efficient development of an integrated public-utility system.

Section 10(e) provides that the Commission may prescribe such terms and conditions with respect to the acquisition of securities or utility assets, including the price to be paid, as it may find necessary or appropriate. Section 10(f) requires that the Commission not approve an acquisition under section 10 unless there has been compliance with applicable State law (unless compliance with such law would be detrimental to the carrying out of the provisions of section 11).

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INTEGRATION AND SIMPLIFICATION OF HOLDING-COMPANY SYSTEMS

Section 11

Section 11 contains the basic integration and corporate simplification requirements under the act. Section 11(b)(1) makes it the duty of the Commission to require each registered holding company and subsidiary thereof take such action as the Commission finds necessary to limit its holding-company system to a "single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system." These limitations are also incorporated by reference into section 10(c) supra to govern acquisitions.

An integrated public-utility system is defined in section 2(a)(29)(A) for an electric system and in section 2(a)(29)(B) for a gas system, both such definitions being concerned with the physical interconnection and coordinated operation of utility properties in a single area or region. An exception to the single integrated system limitation is found in the (A)-(B)-(C) clauses of section 11(b)(1), under which one or more additional integrated systems may be retained by a registered holding company if the Commission finds that --

(a) each of the additional systems cannot be operated independently without loss of substantial economies;

(b) all such additional systems are located in one state, or in adjoining states, or in a contiguous foreign country; and

(c) the combination of systems is not so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

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Section 11(b)(2) provides that the Commission shall require each registered holding company and each subsidiary thereof to take such steps as may be necessary to insure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system . It also provides that there shall be not more than two tiers of holding companies over an operating public-utility company.

Section 11(c) contains provisions concerning compliance with Commission orders under section 11(b). Section 11(d) provides that the Commission may apply to a court, in accordance with the provisions of section 18(f), to enforce compliance with an order issued under section 11(b). Section 11(e) provides that a registered holding company or subsidiary thereof may submit a plan for compliance with the provisions of section 11(b), sets forth the standards for Commission approval of such plan, and provides the Commission may apply to a court to enforce and carry out the provisions of such plan. Section 11(f) provides that in Federal court proceedings for reorganization of a registered holding company or subsidiary thereof, plans of reorganization must be approved by the Commission, after opportunity for hearing, prior to submission in court; and that the Commission may require its approval of fees and expenses in connection with any proceeding. Section 11(g) contains

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provisions concerning the solicitation of proxies concerning any reorganization plan or plan for divesting control, securities or assets, or plan for the dissolution of any registered holding company or subsidiary thereof.

AFFILIATE TRANSACTIONS

Section 12

Section 12(a) prohibits a holding company from borrowing or receiving any extension of credit or indemnity from any public-utility company in the same holding-company system or from any of its subsidiaries.

Section 12(b)-(g) subject certain intra-system transactions to regulation by declaring them unlawful if in contravention of the Commission's rules, regulations or orders. In general the Commission's rules require that authorization be obtained for significant departures from the statutory prohibitions summarized below:

(1) no registered holding company or subsidiary thereof may lend or in any manner extend its credit to or indemnify any company in the same holding company system (section 12(b));

(2) no registered holding company or subsidiary thereof may declare a dividend out of capital surplus or acquire any of its securities (section 12(c));

(3) no registered holding company may sell any security which it owns of any public-utility company or any utility assets (section 12(d));

(4) no solicitation of the stockholders with respect to any security of a registered holding company or subsidiary thereof may be effected (section 12(e)); and

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(5) no other transaction between affiliates in a registered holding company system may be effected (sections 12(f) and 12(g)).

Section 12(h) makes it unlawful for any registered holding company or subsidiary to make any contribution in connection with the candidacy, nomination, election or appointment of any person for or to any office in the United States, a State or any political subdivision of a State, or to make any contribution to or in support of any political party or any committee or agency thereof. It should be noted that the prohibition in section 12(h) against certain contributions with respect to Federal elective offices was eliminated by enactment of the Federal Election Campaign Act Amendments of 1976 (Pub. L. No. 94-283, May 11, 1976). Section 321(b)(2)(c) of that statute (codified at 2 USC §441b(b)(2)(C)) created a specific exclusion from the term "contribution" in section 12(h) of the 1935 Act for "the establishment, administration, and solicitation of contributions to a separate segregated fund to be utilized for political purposes by a corporation . . ."

Section 12(i) makes it unlawful for any person employed or retained by any registered holding company or subsidiary thereof to advocate any matter affecting any registered holding company or subsidiary thereof, before the Congress or any memeber or committee thereof, or before the Securities and Commission or the Federal Power Commission (now Federal Energy Regulatory Commission), unless such person files a report with the Securities and Exchange Commission with respect to such activity.

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Section 13

Section 13 of the Act governs the activities of service companies. Section 13(a) generally prohibits a registered holding company from acting as a service company. Section 13(b) prohibits the entry into or performance of any intrasystem service, sales or construction contracts except in accordance with the terms and conditions as the Commission may prescribe by rules, regulations or order as necessary and appropriate "to insure that such contracts are performed for the benefit of such associate companies at cost, fairly and equitably allocated among such companies." The Commission may, by rule or order, exempt transactions from this requirement, principally if such transactions "involve special or unusual circumstances or are not in the ordinary course of business."

Section 13(c) authorizes the Commission to prescribe by rule or order terms and conditions concerning the determination of costs and their allocation, the duration of contracts, the making and keeping of accounts and cost accounting procedures, and the filing of reports.

Section 13(d) contains the standards under which the Commission shall approve any service company. In general it requires that such company be so organized "to insure the efficient and economical performance of service, sales, or construction contracts by such company for member companies, at cost fairly and equitably allocated among such member companies, at a reasonable saving to member companies over the cost to such companies of comparable contracts performed by independent persons."

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Sections 13(e) and 13(f) contain provisions making it unlawful for any affiliate of a public-utility company and for any person principally engaged in the performance of service, sales or construction contracs for public-utility or holding companies (even though such affiliate or person is not a part of a registered holding company system), to enter into or perform certain contracts in contravention of the rules, regulations and orders the Commission may have regarding such subjects.

Section 13(g) provides that the Commission shall from time to time conduct investigations with respect to service, sales and construction contracts in the utility industry, and make reports to Congress, together with such recommendations as it deems advisable.

REPORTS, ACCOUNTS AND RECORDS

Section 14

Section 14 provides that the Commission may by rules, regulations or order require that every registered holding company and mutual service company file such annual, quarterly and other periodic and special reports, in such form and detail and with such information as to various matters, as the Commission may prescribe.

Section 15

Section 15 provides, generally, that every registered holding company and every subsidiary thereof shall make, keep and preserve for such periods such accounts and records as the Commission deems necessary. It also provides that the Commission may by rule or regulation prescribe uniform methods for keeping accounts required under the section, and that all books, accounts and records required to be kept shall be subject to examination by the Commission.

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LIABILITY FOR MISLEADING STATEMENTS

Section 16

Section 16(a) imposes the civil liability of section 18 of the Securities Exchange Act of 1934 in connection with false or misleading statements in any application, report, registration statement or document filed under any provision of the act or rule, regulation or order thereunder.

Section 16(b) provides that the rights and remedies under the act (except as provided in section 17(b)) shall be in addition to those that may exist under the Securities Act of 1933 or the Securities Exchange Act of 1934, or otherwise at law or in equity, but that no person may recover a total amount in excess of his actual damages.

OFFICERS AND DIRECTORS

Section 17

Sections 17(a) and (b) corresponds to sections 16(a) and (b) of the Securities Exchange Act of 1934, and cover transactions by officers and directors of registered holding companies in the securities of those companies and their subsidiaries.

Section 17(a) requires that reports be filed by every officer and director of a registered holding company of his beneficial ownership of securities of such registered holding company or subsidiary thereof, and reports of changes therein.

Section 17(b) provides, with certain exceptions, that any profit realized by such officer or director from transactions in a period of less than six months in securities of such company shall be recoverable by the company whose securities were the subject of the transaction. No remedy is available under section 17(b) if a remedy is given under section 16(b) of the Securities Act of 1934.

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Section 17(c) provides that no registered holding company or subsidiary thereof shall have as an officer or director, any executive officer, director, partner, appointee or representative of any bank, trust company, investment banker, or banking association or firm, or of a corporation a majority of whose stock is owned by any bank, trust company, investment banker, or banking association or firm, except in cases as the Commission by rule or regulation permit.

ADMINISTRATIVE PROVISIONS

Section 18

Section 18 contains provisions dealing with investigations by the Commission, injunctions to prevent or stop violations of the act, and suits to enforce compliance with the act or any rule, regulation or order issued thereunder.

Section 19

Section 19 contains provisions dealing with hearings before the Commission. The Commission, by rule or regulation, is directed to admit as a party in any proceeding any interested State or state-related entity, and may admit as a party any representative of interested consumers or security holders, or any other person whose participation may be in the public interest or for the protection of investors and consumers.

Section 20

Section 20 contains provisions concerning the rule-making power of the Commission and its authority to issue orders. Among other things, it provides that orders "shall be issued only after opportunity for hearing" (section 20(c)).

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Section 21

Section 21 declares that the act shall not affect rights or obligations under the securities laws, and preserves the jurisdiction of other Federal, state and local agencies "insofar as such jurisdiction does not conflict with [the Act"].

Section 22

Section 22 deals with information filed with the Commission and its availability to the public.

Section 23

Section 23 requires the Commission to report annually to the Congress concerning its work for the preceding year, including such recommendations for further legislation concerning the act as it may find advisable.

Section 24

Section 24 provides for court review of orders issued by the Commission by any party or person aggrieved thereby.

Section 25

Section 25 deals with the jurisdiction of Federal courts over civil and criminal actions under the act.

Section 26

Section 26 provides that contracts made in violation of the act, or of any rule, regulation or order issued thereunder, shall be void.

Section 27

Section 27(a) makes it unlawful for a person to cause to be done through another person anything which it would be unlawful for the first such person to do under the act or any rule, regulation or order thereunder. Section 27(b) makes it unlawful for any person to prevent compliance with the act.

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Section 28

Section 28 makes it unlawful for any person in connection with the issue or sale of securities of a registered holding company or subsidiary thereof to represent that such security has been guaranteed, sponsored or recommended for investment by the United States or any agency or officer thereof.

Section 29

Section 29 provides for criminal penalties for certain willfull conduct in violation of the act or rules, regulations or orders thereunder.

Section 30

Section 30 authorizes and directs the Commission to make studies and investigations of public-utility companies and make public from time to time its recommendations as to the type and size of geographically and economically integrated systems which can best promote and harmonize the interests of the public, the investor, and the consumer. It also authorized and directed the Commission to make a study of investment trusts and companies, and report the results of its study and its recommendations to the Congress on or before January 4, 1937. The Commission's reports pursuant thereto became part of the findings referred to by the Congress in the Investment Advisors Act of 1940 and the Investment Company Act of 1940.

Section 31

Section 31 deals with employees of the Commission.

Section 32

Section 32 contains a "separability" provision.

Section 33

Section 33 gives the Act the short title of the "Public Utility Holding Company Act of 1935."

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APPENDIX C

Statement of

Aaron Levy

Director, Division of Corporate Regulation

Securities and Exchange Commission

on the

Administration

of the

Public Utility Holding Company Act of 1935

Presented To

Subcommittee on Energy Conservation and Power

of the

House Committee on Energy and Commerce

(H.R. 5220, 5465, 6134)

June 9, 1982

Chairman Ottinger, I thank you for your invitation to testify before this subcommittee regarding the Public Utility Holding Company Act of 1935 (the "Act"). In your letter to SEC Chairman Shad, dated May 10, 1982, you indicated your interest in the key provisions of the Act, how they have been implemented or applied in the recent past and at present, with examples, and an explanation of the purpose to which these provisions have been applied. Your interest is only in the factual content of my testimony, without any opinion on whether the Act should be amended or repealed. I assure you, sir, that the statement I here present is in full accord with your request and intention.

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Chairman Shad's statement relates the legislative background of the Act, its basic purpose as expressed in the geographic integration provisions of Section 11(b)(1) and the extensive reorganizations under the corporate simplification requirements of Section 11(b)(2). Pursuant thereto, many holding companies have been liquidated, underlying subsidiaries have been merged, recapitalized, sold or spun off as independent operating companies. All this was substantially accomplished by 1955.

There are now nine active electric and three gas utility holding-company systems registered under the Act. They have combined assets of about $60 billion and in 1981 had about $28 billion in revenues. They include 60 operating utility subsidiaries, gas and electric, with retail service areas across 24 states.

I

1. Regulation of security issues (Sections 6 and 7)

Sections 6 and 7 in general provide for Commission authorization of the issue and sale of securities by registered holding companies or their subsidiaries. A security is comprehensively defined in Section 2(a)(16) to include bonds, debentures, stock, a note, various types of certificates, and any instrument commonly known as a "security." It includes also a guaranty or assumption of liability of another company or a warrant or right to subscribe to a security. Sections 6 and 7 apply to short-term borrowing in excess of 5% of capitalization of the borrowing company. Commission authorization is also required for any

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modification or alteration of priorities, preferences, voting or other rights of any outstanding security of a company subject to the Act.

Section 7(c) specifies the kind of securities which may be issued by members of registered systems. Under Section 7(c)(1) common stock and first mortgage bonds are identified as the primary means of financing utility systems, but Section 7(c)(2) permits the Commission to authorize other forms of financing. The Commission has regularly authorized the issuance of operating company preferred stock, and, in suitable cases, financing by lease and revenue bonds. The issuance of holding company debt, for example, is limited under Section 7(c)(2)(D) to "necessary and urgent corporate purposes" and when other means of financing would impose unreasonable financial burdens.

Section 7(d) is concerned with the quality and cost of the securities to be issued. Section 7(d) requires (1) that the securities be reasonably related to the capital structure of the issuing company and the holding-company system and to earning power; (2) that the particular security be appropriate for the economical and efficient operation of the system's business; and (3) that the cost of financing be reasonable. In broad perspective each financing must fit the capital structure of the system and not prejudice future financing.

The experience of the 1930s showed that state regulation of the securities issued by subsidiaries was frustrated when such securities were issued to a holding company whose own unregulated capital structure thus became the effective capitalization of the system.

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Section 1(b)(1) specifies that the public interest and the interest of investors and consumers are affected when "securities are issued without approval or consent of the States having jurisdiction over subsidiary public-utility companies...." It also notes the same adverse effects when securities are issued by public-utility subsidiaries under circumstances which subject them "to the burden of supporting an overcapitalized structure," thereby tending "to prevent voluntary rate reductions."

Using the reorganization powers to eliminate corporate complexities in the securities structure of the system, and aided by the standards of Section 7, the Commission effectively cleared away defaulted securities, including preferred stocks with dividends in arrears and holding-company debt. This opened the way for new common stock financing to create the balanced utility capital structures mandated by Section 7. In the process, the Commission developed, largely through a consensus, minimum essential protective provisions for first mortgage bonds and preferred stock. These were codified in statements of policy promulgated under the Act on February 16, 1956 (HCAR No. 13105, first mortgage bonds; HCAR No. 13106, preferred stock), about 20 years after passage of the Act.*

The aim of Sections 6 and 7 is a simple and prudent capitalization of the registered holding company and its subsidiaries.

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* Commission rules, notices and orders are initially published as Holding Company Act Release No.——— (HCAR No.———)

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The general standards developed by the Commission for the operating utility is a maximum of 55% long-term debt, a minimum of 30% common equity, and about 10% preferred stock. These are general standards, not inflexible. For the holding company, which holds only common stocks of its subsidiaries, its permanent capital is common stock, which represents the consolidated common equity of its subsidiaries, that for 30% to 40% of their capital are dependent upon the holding company. It also issues short-term debt to provide common equity to its subsidiaries, pending permanent refinancing by periodic sales of common stock. This means that the capitalization of the public-utility subsidiaries and of the holding company must be constructed in light of their mutual needs and the interdependence upon one another.

Utility companies provide an essential service in their territories. They are not permitted to cope with adversity by curtailing or abandoning service. But their business involves a continuous and large scale replacement and improvement of expensive facilities, which require a frequent supply of new capital. Both at the state level and under the Act, great emphasis is placed on maintenance of conservative capital structures, which will tend to produce economies in cost of new capital, and in the hope or expectation that the utility's credit will not be cut off or seriously affected by a depressed economy.

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2. Administration of Sections 6 and 7

Since the early 1960s the size and pace of financing of registered systems and of the industry as a whole has accelerated rapidly. The magnitude of this financing reflects the growth, almost entirely internal, of the physical facilities required to meet demand. The following statistics from the Federal Power Commission's annual consolidated report on all investor-owned electric utilities in the United States, indicate the magnitude of such growth:

	1951	1961	1971	1979**
		(in billions)		
Net utility plant	$ 16.6	$ 38.4	$ 82.3	$ 192.6
Electric revenues	5.2	10.6	22.3	72.9
*Sales to consumers KWH	263.1	544.9	1,149.4	1,604.9

* Excluding wholesale sales to purchasers for resale. It omits a significant amount of wholesale sales to municipal or cooperative retail systems.

** Latest published

Net utility plant is about the same as the amount of the outstanding debt and equity securities, including bank borrowings in anticipation of long-term or permanent financing. It includes construction work in progress, which has grown disproportionately as the time required to complete major additions has lengthened from a

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median of two or three to eight or ten years. The disproportionate growth of electric revenues in the 1970s reflects principally radical increases in fuel and capital costs, the latter including rising interest rates and inflation in cost of construction. In recent years much larger and more frequent offerings of securities were required, while volatile markets make the timing of offerings difficult and critical. The registered systems, gas and electric, are of course, an integral part of that growth, with the same dependence on the capital markets, as shown in the following table:

	October 1, 1980 through September 30, 1981 (billions)	October 1, 1981 through May 26, 1982 (billions)
Bonds	$ 1.74	$ 1.35
Long-Term Notes and/or debentures	0.53	1.11
Pollution Control Financings	0.27	0.22
Preferred Stock	0.28	0.27
Common Stock	0.78	0.34
Subtotal	$ 3.60	$ 3.29
Short-Term Debt	7.15	2.51
Total	$10.75	$ 5.80

The total of such financings was $8.2 billion in fiscal 1978; $6.5 billion in fiscal 1979; and $8.8 billion in fiscal 1980.

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3. Competitive Bidding

Sections 7 sets the standards on the type and amount of security issues, to provide sound investment quality for these securities. The price at which they are to be sold, reflecting investment risks, and the cost to the issuing company are dependent on the securities markets and competitive bidding, as provided by Rule 50 adopted on April 8, 1941 (HCAR No. 2676). Rule 50 requires that public offerings of securities of members of registered systems be made on sealed bids pursuant to public invitation for proposals. The Rule permits the Commission to grant exceptions. An exception is inherent in an authorization to exchange securities for specific property or for a merger or tender offer. For the same reason, the Commission's authorization, in recent years, of dividend reinvestment plans and employees stock ownership plans included the necessary exception from Rule 50. Issuers and underwriters exploring the Eurodollar market have been advised that an exception would be available for such offerings.

The Commission has not been receptive to repeated proposals to abandon competitive bidding, either outright or by an indiscriminate grant of exceptions for security issues which are suitable for public offering under competitive bidding. In 1974, the effects of the fuel crisis, which fundamentally and adversely altered the major costs element in both gas and electric service, created demonstrably unsettled conditions in the market for utility stocks. On July 19, 1974 (HCAR No. 18504), the Commission proposed a six-month suspension

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on competitive bidding for issues of common stock of registered holding companies. The suspension became effective immediately when pending applications for exceptions were duly granted. The adoption of the proposal (HCAR No. 18646), set March 31, 1975 as the end of the suspension period. Public comments were received and hearings were held on whether it should be extended and whether competitive bidding for preferred stock or bonds should also be suspended.

After a thorough review of the subject, including the experience with negotiated offerings during the suspension period, the Commission declined to extend the suspension (HCAR No. 18898). Competitive bidding under Rule 50 remains in effect for most significant public offerings, subject to particular exceptions as the need therefor is shown.

4. The Budget Method of Authorization

Although Sections 6 and 7 are directed in terms to individual issues of securities, the statutory standard of a balanced capital structure has always required a broader perspective. A bond issue, ipso facto, increases the debt ratio, while a stock issue decreases it, and the effect of short-term borrowing depends on how it is to be repaid. Any particular transaction has to be put into the context of the issuer's total capital requirements and its plans for meeting those total requirements over a reasonable period of time, that is, its capital budget.

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The escalation of construction in the 1960s led to a pattern of large short-term borrowing by operating subsidiaries under bank lines of credit, paid by annual or semi-annual issues of bonds and preferred stock and of common stock investment by the holding company, which in turn was dependent on periodic offerings of its own common stock to the public. Day-to-day cash requirements of this financing cycle were managed by the flexible bank lines.

The Commission avoided a multiplicity of applications and orders by basing its authorization of the short-term or bank borrowing and the related investment by the holding company in its subsidiaries on a system budget, generally in the form of a single order authorizing maximum limits for a one or two year period. The budget that management prepares in the ordinary course of business for those large systems provides initial answers to the issues raised by Section 7(d), and the continued validity of the forecasts are again considered and reviewed when long-term security issues are authorized to retire the bank loans.

This principle was extended about two years ago to long-term financing, debt and equity. Volatile markets, due principally to rapidly fluctuating interest rates, were making it difficult to fix the amount and timing of a public offering too far in advance. But it was simple to modify an order under Section 7 to include the full year's financing requirements, to be sold in one or more installments as market conditions dictated, since our review of the substantive requirements under Section 7 had actually been conducted under the budget method previously described.

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This administrative revision has reduced the number of applications, notices, and orders, which had begun to increase as the need to issue long-term securities became more frequent. It anticipated the Commission's reform of the registration process pursuant to Rule 415 under the Securities Act of 1933. A public notice under the Act imposes a 30 to 40 day period between application and order, which is rarely exceeded for financing applications. It runs concurrently with the registration process under the Securities Act of 1933, as in effect previously and currently under the simplified registration recently adopted by the Commission.

5. Limitations on Short-term Borrowing

The large construction budgets, characteristic of electric utility companies over the past two decades, required continuous raising of new capital, typically through a financing cycle noted previously. For major utility companies, such as the registered systems, short-term borrowings are substantial. The lines of credit for the twelve registered systems have reached an annual level of about $7 billion a year, $500 million for the larger individual utility companies.

These funds are spent, viewed incrementally, on physical additions to permanent facilities. These expenditures are unlike financing of inventory or the acquisition of finished products for resale. The financial soundness of the loans and of the borrower depends on prompt refinancing by common stock and long-term

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securities. A failure to refinance the current year's loans might imperil the ability to complete construction on time, and deferred construction may be costly to investors and consumers. Accordingly, the principal test for short-term debt authorization under the Act is the ability to repay in a timely fashion. The cases of Georgia Power Company and Alabama Power Company, both subsidiaries of The Southern Company, provide good examples of the intricate effects of unanticipated events.

In 1973 Georgia Power Company, then a $2.5 billion electric utility company serving most of the state of Georgia, was engaged in a construction program for which it had budgeted $3.3 billion in the next four years. Both it and Southern were experiencing some difficulties in raising long-term capital to finance this rate of growth. A consumer group intervened to oppose Georgia's $150 million bond issue, scheduled for sale early in 1974, and its application for $250 million short-term borrowing. The Commission summarily approved the bond issue, which was required to refund outstanding short-term debt.* The Commission also authorized the sale of $165 million of Southern common stock principally for investment in Georgia.** It set for hearing the short-term application for $250 million of bank loans. After an evidentiary hearing and review, the Commission granted the requested authorization.***

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* Georgia Power Co., 45 SEC 427 (1974)
** The Southern Co., 45 SEC 623 (1974)
*** Georgia Power Co., 45 SEC 610 (1974)

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Three months thereafter (HCAR No. 18750), Georgia Power reduced the burden of its enormous construction program by changing its historical policy of 100% ownership of its generating plants. It sold undivided interests in the plants under construction to rural electric cooperatives and to municipalities, both wholesale customers of Georgia Power. It recovered about $200 million for prior construction costs to the date of sale, and the new joint owners would share in future construction costs. The initial $200 million was immediately applied to repayment of bank loans. Georgia has not made significant use of short-term loans since 1975.

Its associate company, Alabama Power Company, faced a somewhat different problem with its bank loans. Alabama Power was unable to undertake long-term financing because of inadequate earnings attributed to prolonged rate litigation, but in the meantime it had built up a formidable level of short-term debt. In March 1979, the Commission refused to authorize a request to increase Alabama's borrowing authorization from $305 million to $555 million (HCAR No. 20970) for lack of evidence of ability to repay. When rate increases were allowed in July 1979, the needed additional borrowings were authorized by the Commission the following month (HCAR No. 21188). About 12 months later, when Alabama's full year's earnings reached the level required under its bond indenture, funding to commerce retirement of its $400 million accumulated bank loans was authorized by the Commission (HCAR No. 21711). It was completed by the end of 1981.

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6. Statements of Policy on Bonds and Preferred Stock and Callability

As noted previously, in 1956 the Commission adopted policy statements regarding certain basic terms for bonds and preferred stock. Actually, the statements codified what had been developed in the course of reorganizations under the Act. Extensive comments were reviewed prior to their formal adoption.

First mortgage bonds must be callable on payment of a reasonable redemption premium. This permits the issuing company, if interest rates decline, to redeem any outstanding series by sale of new bonds at a lower interest cost. Except for refunding maturing bonds, additional bonds may be issued only to the extent that (a) the total amount of bonds to be outstanding are not more than 60% of the defined value of bondable property (property coverage); and (b) operating income, before income taxes, of the issuer for at least 12 consecutive months in the previous 15 months, is at least twice the annual interest requirements on the bonds to be outstanding and prior obligations (interest coverage).

A renewal and replacement fund, representing essentially the straight line depreciation allowance, currently about 3% of depreciable property, and a sinking fund of at least 1% of the total original principal amount of bonds issued under the indenture (deducting series fully retired) must be set aside annually. These requirements may be and usually are satisfied by certifying property additions. The alternative is retirement of bonds. Each series of bonds restricts the payment of common dividends to earnings subsequent

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to its issuance plus an amount not to exceed one year's current dividend requirements. Past accumulations of retained earnings, which are universally invested in physical plant, are in effect treated as permanent common equity.

Preferred stock, like bonds, must be callable. Preferred dividends must be cumulative and preferred shareholders shall have the right to elect at least a majority of the board of directors as long as four quarterly dividends are in arrears. The issuing company may not acquire shares of its preferred stock if preferred dividends are in arrears. Unsecured debt may not exceed 20% of capitalization, with a sublimit of 10% on such debt of less than 10 years maturity, without the consent of at least a majority of the preferred stock. As restrictions are included in the articles of incorporation, the consent of the preferred stock requires a vote to amend the articles.

Coverage tests for issuance of additional preferred stock require that (a) income before interest for 12 consecutive months in the previous 15 months be at least 1.5 times the sum of the issuer's interest and preferred dividends, and (b) common equity at least equal to the involuntary liquidation preference of the preferred stock (a 200% book equity).

The Commission's statement of policy regarding first mortgage bonds specified that the indenture "shall provide that the bonds can be called by the obligor for redemption at any time upon reasonable notice and with reasonable redemption premiums, if any." In the absence of very special circumstances, the maximum initial redemption premium is one year's interest, declining at defined intervals over the life of the issue.

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The Commission amended this requirement in 1969 (HCAR No. 16369), to permit an initial five-year bar on refunding "by the issue of debt securities at lower interest costs." The refundability restriction, unlike a "no call" provision, preserved the issuer's right to retire the issue at any time, but protected holders from the risk of the bonds being redeemed quickly to take advantage of an early change interest rates. The five-year period was based on extensive data indicating strongly that the five-year non-refundability clause produced a modest, but significant, reduction in interest rates, on the order of 1/4 of one percent. It allowed also a like limitation on preferred stock (HCAR No. 16758).

On October 23, 1975 (HCAR No. 19224), the Commission invited public comment on whether the period should be extended to ten years. The Commission noted that the ten-year clause was widely used during the difficult markets from June 1974 to January 1975. Its request for comments sought information as to the views of institutional investors who have been substantial purchasers of utility bonds and preferred stock, and for quantitative data as to any interest differential. After reviewing the comments, the Commission announced (HCAR No. 20509) that no change would be made. The record, including a staff analysis of all significant public sales of utility senior securities for 1975 and 1976, did not support the suggestion that a measurable reduction in cost of money would result from extending non-refundability to ten years.

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One of the reasons for providing callability is the Commission's experience with non-callable senior securities. They impeded adjustment of the company's operation to changing conditions. The reorganization powers of Section 11(b)(2) had to be invoked to cut more than one of these Gordian knots. Liens and covenants incident to an outstanding bond series restrict the issuing companies for 25 or 30 years and may take on a significance entirely unanticipated. Sometimes redemption may not be economical, and bondholder consent to modification of the indenture may not be forthcoming except at a price the company cannot afford to pay.

A special kind of adverse effect was examined recently by the Commission in West Texas Utilities Company (HCAR No. 21041). The bond indenture of this subsidiary of Central & South West Corporation required that the utility company's income, for purposes of dividend payments and issuance of new bonds, be calculated by deducting the difference between 15% of its operating revenues and its actual maintenance expense, rather than deducting the depreciation allowance.

The percent-of-revenue clause was widely used when the indenture was created in 1943, because manipulation of plant accounts and depreciation accounting in the 1920s left little credibility for the book figures. An important aspect of reorganizations under the Act and concurrent action by other regulatory agencies was a general audit and revision of capital accounts and depreciation. The Commission's 1956 Statement of Policy adopted a depreciation allowance as a standard for future indentures, but the outstanding percent-of-revenue clauses

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remain in effect as long as bonds issued thereunder continued to be outstanding. In West Texas case this would be until the year 2003.

The calculation continued to produce a reasonable approximation of the depreciation allowance until fuel cost escalation in the early 1970s disrupted that historical relationship. The revenues to pay for the increasing cost of fuel had no relationship to plant or maintenance, and 15% of the additional revenues produced large excess deductions. In only five years the restrictions forced a serious distortion in West Texas capital structure, increasing its common equity ratio by 8%, to 55.5%, and reducing the debt ratio to 40.9%.

In utility finance and ratemaking, such ratios mean generally that capital is being raised inefficiently and at excessive cost, to the prejudice of both investors and consumers and contrary to the requirement of Section 7(d)(3) of the Act. In the West Texas case the indenture happened to contain a clause authorizing the Commission by order to permit dividends despite the restriction. Accordingly the Commission's order authorized West Texas to borrow $15 million to pay a special common dividend which restored its capitalization to a 52.8% debt and 43.7% common equity. For the future the order authorized payment of common dividends based on earnings for the previous 12 months computed under depreciation accounting.

7. Lease Financing

In the early 1970s, the development of sale and leaseback financing presented a serious problem under the Act. Under this type

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of financing, a trustee--usually a bank or other financial institution--and the beneficial owners, who supply the equity financing, own the equipment that is leased to any utility company, whether or not this utility company is subject to the Act. Sections 2(a)(3) and 2(a)(4) in effect define respectively an electric and gas utility company as a company that "owns" or operates any utility facilities or any associated physical part thereof. Read literally, that would make the lessor and each benefical owner a public-utility company, and any parent thereof a holding company.

After granting at first individual applications for exemption, the Commission proposed Rule 7(d) (HCAR No. 17843) and adopted the same on May 31, 1973 (HCAR No. 17980), based on its authority under Section 20(a) to define technical terms. It determined that the lessor as trustee and the beneficial owners would not be deemed to "own" leased facilities provided that the terms of the lease with the public utility were approved by the State commissions having jurisdiction over its rates and services. It required the filing of a simple certificate of compliance to establish exclusion from the Act. Lease financing by this simple procedure proved effective, as shown by the following table:

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RULE 7(d) CERTIFICATES
-in millions-

Year	Utility Equipment	Nuclear Fuel	Other	Total
1973	$ 107	$ 338	$ 21	$ 466
1974	87	82	4	173
1975	19	114	—	133
1976	360	579	—	939
1977	2	99	—	101
1978	269	243	1	513
1979	7	998	—	1,005
1980	12	575	—	587
1981	40	2,043	22	2,105
1982 (5 months)	650	2,165	—	2,815
	$1,553	$7,236	$48	$8,837

The liberalized leasing requirements of the Economic Recovery Tax Act of 1981 revived in another form some of the interpretive questions referred to. They were resolved by a public release of the Commission on November 4, 1981 (HCAR No. 22259), as soon as the Internal Revenue Service issued pertinent regulations under the new law, which in effect allow the sale of tax credits but in the form of a sale and leaseback. The Commission's release concluded that qualified leases under the amended tax laws did not involve either a disposition or acquisition of utility facilities or securities requiring

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authorization by the Commission under the Act for members of registered systems, and that the tax title to such facilities attributed to lessors was so attenuated that lessors were not deemed owners under Sections 2(a)(3) and 2(a)(4) of the Act, and hence did not need the exclusion pursuant to the terms and conditions prescribed by Rule 7(d).

II

1. Acquisitions (Sections 9 and 10)

Section 9(a)(1) requires Commission approval for an acquisition of securities, utility plant, or any interest in any other business, by any member of a registered holding company system, and Section 10 specifies the standards to be applied in granting such authorization. Section 9(a)(2) requires approval under the same standards for acquisitions by any others who, as a result of acquisitions, become affiliates of two or more public-utility companies. For this purpose, an affiliate of a public-utility company means any person or company that, directly or indirectly, owns or controls 5% of the voting securities of such company. The two or more acquisitions subject to Section 9(a)(2) may occur in sequence or concurrently. An acquisition by a company of all the stock of one public utility makes the acquiring company a holding company. If only one utility is involved, this single acquisition is not subject to Section 9(a)(2) and hence requires no approval under Section 10. But the new holding company must register unless it qualifies for exemption.

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Section 10 is linked to Section 11. Section 10(c) provides that an acquisition shall not be approved unless the Commission finds that it will tend toward the economic and efficient development of an integrated public-utility system (defined in Section 2(a)(29)), or if it is "detrimental to the carrying out of the provisions of Section 11." In substance, Section 9(a)(1) bars a registered holding-company system from making an acquisition if Section 11 would prohibit its retention. Section 9(a)(2) is directed to controlling the creation of new holding companies by making two or more utility acquisitions subject to the standards of Section 10, even if the holding company qualifies for an exemption under Section 3(a) of the Act.

Section 10(b) relates approval of the acquisition to a determination of whether the price is reasonable, whether it would result in an undue concentration of control, and whether it will unduly complicate the capital structure of the holding-company system or affect its proper functioning. Section 10 does not preempt state laws. Acquisitions, like financings under Sections 6 and 7, must comply with applicable state laws.

2. Acquisitions of public-utility companies.

Such acquisitions do not occur often. Utility systems have expanded to meet increasing demand largely through internal growth, joint utility ventures and regional power pools. But acquisitions of

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independent utilities by holding companies have come to the Commission from time to time.

In 1975 the Commission declined to approve a new holding-company system that would combine New England Electric System and Eastern Utilities Associates, both registered holding companies, and Boston Edison Company, because of insufficient evidence to support the claimed operating savings as a result of the affiliation.* It approved the organization of a new holding-company system, Northeast Utilities, with three utility subsidiaries, one in Massachusetts and two in Connecticut.** It approved the acquisition, by a tender offer, of the stock of Columbus and Southern Ohio Electric Company by American Electric Power Company (HCAR Nos. 20633, 21433, 21768). Other acquisitions, not of such magnitudes, have been approved by the Commission.

3. Joint Ventures (Rules 14, 15, 16)

Rule 14 is directed to a joint venture in a "power supply company," which is an electric utility company as defined in Section 2(a)(3) of the Act, because it is organized as a separate entity, unlike generating facilities jointly owned by participating utilities as tenants in common. Thus, without Rules 14 and 15, participants otherwise not subject to the Act, would be required to apply with the provisions of the Act relating to acquisitions and exemptions.

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* New England Electric System, 45 SEC 684 (1975).
** Northeast Utilities, 42 SEC 963 (1966).

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To encourage such joint projects Rule 14 exempts participating utilities from Sections 9(a)(2) and 10 as to this project company. One of the conditions of the exemption is that financings and acquisitions are expressly authorized by the appropriate commissions with authority over rates and service. Rule 15 provides that the exemption for a holding company is not affected by an exempted acquisition under Rule 14 (HCAR No. 21881). The participation in a power supply company by a registered system remains subject to Sections 9(a)(1) and 10. These requirements did not pose the problem to which Rules 14 and 15 are addressed.

Rule 16, adopted in November 1980 (HCAR No. 21797), provides an exemption from affiliate or subsidiary status for a joint venture to construct pipeline facilities or a coal gasification plant. Such ventures are not utility businesses under the Act. But if a registered holding company, directly or through a subsidiary, were to acquire a 10% participation interest, the project company would be a subsidiary of a registered holding company. A registered holding company may experience some difficulties in attracting other participants, and inversely other participants not subject to the Act might for the same reasons exclude the registered holding company. The exemption provided by Rule 16 extends to such projects only if the participation interest of the registered holding company does not exceed 50%. The exemptive provisions of Rule 16 extend also to affiliates of the project company.

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4. Organization of Fuel Subsidiaries

The organization by a registered holding of a subsidiary to buy or develop fuel supplies for its associate companies is a non-utility business, though functionally related. Its organization and acquisition is subject to Section 9(a)(1), which includes an acquisition of any interest in another business, and the required approval is governed by the relevant provisions of Section 10. Sales to associate utilities are subject to Section 13(b), which provides that such services be "performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies." Exemptions from cost are authorized, by rule or order, conditionally or unconditionally, in cases that "involve special or unusual circumstances" or on other grounds therein stated.

Ownership of mines and related transportation facilities were not uncommon in 1935, and their retention was permitted by the Act. However, the fuel supply for the exponential growth of generation capacity in the 1950s and 1960s was procured in the market or by contract with independent producers. The majority of electric holding company systems were dependent on oil and gas as a fuel for electric generation, partly due to conversion from coal in the late 1960s. These included Central and South West Corp. ("C&SW"), Middle South Utilities Corp. ("Middle South"), New England Electric System ("NEES"), General Public Utilities Corp., and Northeast Utilities.

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American Electric Power Company ("AEP") expanded its own coal supplies, but less than 15% of its annual consumption came from AEP coal subsidiaries.

The fuel crisis that emerged in the 1970s drastically affected the fuel supply of electric utility companies. Market prices and the utilities' costs escalated, established supplier relationships were impaired, and concurrent economic problems in the transportation industry created significant uncertainties about reliability of delivery. Large advances, guarantees, and other concessions were demanded by unaffiliated suppliers, in addition to liberal escalation clauses as to price.

Many of the larger electric utilities, including the registered systems, responded by acquiring their own supply sources for a substantial percentage of their fuel requirements and transport. In 1971, Middle South established System Fuels, Inc. ("SFI"). In 1974, NEES added New England Energy, Inc. ("NEEI"), and in 1978, C&SW established Central and South West Fuels, Inc. ("C&SW Fuels"). With natural gas and oil becoming more volatile as to price and availability, the electric registered systems also undertook to construct coal-fired baseload plants to meet future needs for electric power.

AEP greatly expanded its own fuel sources through coal mining subsidiaries in West Virginia, Ohio and Utah. C&SW, through its fuel procurement subsidiary, purchased coal reserves in Texas, Oklahoma, and Arkansas. During the 1970's, Middle South and NEES remained

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dependent on oil and gas as boiler fuel. At present, Middle South is constructing coal-fired and nuclear power generating plants, but for the remainder of this decade will be dependent on oil and gas for over 40% of generation needs. The NEES system, which was dependent on fuel oil and natural gas, is now converting baseload oil plants to coal.

Mining, oil and gas development and transportation all involve large capital investments, so the cost of capital is an important factor. As the fuel subsidiaries are wholly-owned, cost of capital computations are based on the imputed capital structure of the utility companies that are served, applying the actual cost of money for that utility company's senior security issues and the return on common equity allowed in the most recent rate case, with appropriate adjusting provisions. The total price is based on full pooling of costs, including amortization of the exploration and development costs.

Fuel development by associate companies often requires ancillary facilities, such as coal cars for unit train service and oil barges. Their continuous use for service to the utilities may not be economical or efficient. Accordingly the fuel companies have been authorized to use idle equipment or surplus capacity to serve non-affiliates on condition that resulting revenues or income be credited against the cost of service supplied to the associate utility companies.

SFI, established in 1971 as a fuel procurement arm of the Middle South system, is a direct subsidiary of Middle South's four electric operating utilities. Until 1976, SFI was principally involved in fuel

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inventory procurement and in oil and gas exploration. In 1976, SFI service was expanded to include all nuclear fuel acquisition, conversion, fabrication, and delivery to the operating companies. Middle South had built one nuclear plant and had under construction three additional facilities to be placed in service in the 1980s. To meet these growing needs for nuclear fuel, particularly the yellow-cake mineral, SFI began in 1978 a uranium exploration program. In the four-year period ending December 1981, SFI had spent $24.8 million on uranium exploration with little success. In March 1982, we were informed by SFI that the uranium exploration program would be abandoned this year.

SFI purchased during the early 1970s tow boats and barges for fuel oil transportation. In 1980, as a result of substanial increase in domestic supply, natural gas was used instead of fuel oil for electric generation. From 1980 to the present time SFI has subleased its excess vessel capacity to non-affiliates. In 1981 gross revenues generated from these subcharters amounted to $7.3 million, all of which was applied to reduce the cost of fuel oil transportation billed to the operating utility companies.

C&SW Fuels is a direct subsidiary of the four electric operating companies of C&SW. It was established in 1978 to function as the procurement and exploration arm of the holding-company system. During the last four years it has been engaged in extensive gas and oil exploration in the Gulf Coast region and in the acquisition of thousands of acres of mineral lease rights for lignite in Texas and Arkansas. The fuel company is responsible for developing, alone or

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by joint ventures with a non-affiliate, lignite mines dedicated to mine-mouth generating plants of the operating companies. The four electric operating utilities of C&SW have all acquired, individually or jointly, rail cars to haul coal from Wyoming to their respective service territories. Should excess coal car capacity develop, these utilities have been authorized to sublease to non-affiliates on conditions previously indicated. The fuel company is now acquiring coal reserves in northern Texas, which will reduce transporation costs.

The coal mining subsidiaries of the public-utility companies in the AEP system are principally engaged in the supply of coal to generating plants of the operating utility company that owns them. The AEP system has developed one of the few utility-owned and operated coal barge and transloading transportation systems for the movement of coal from mine to generating plant. The operating utilities own over 6,000 coal railroad cars to haul coal both from Wyoming and Utah to the Mississippi River and within the Appalachian region of Ohio, Virginia, and West Virginia. During the last 12 years, AEP has expended over $1.1 billion on coal mine development, expansion and related transportation facilities. The AEP system now provides for its utility subsidiaries over 40% of their coal requirements, which exceed 43 million tons annually.

NEEI, wholly-owned by NEES, was organized to provide fuel for New England Power Company ("NEPCO"), the generating and transmission subsidiary for the NEES system. It has been engaged in a joint venture, since 1974, with Samedan Oil Corporation, a non-affiliate,

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for oil and gas exploration (HCAR No. 18635), under which NEEI receives 50% of all reserves acquired.

During the 7-1/2 years to date, NEEI has invested $262 million in the joint venture. As of March 31, 1982, the joint venture had drilled 994 wells, of which 60% were productive. This program has provided for NEEI 13.1 million equivalent barrels of proven and probable oil and gas reserves, of which 79% is natural gas. Since NEPCO does not use natural gas in its generators, NEEI sells or exchanges the same to or with non-affiliates to obtain suitable fuel oil for NEPCO. As a result NEEI has saved NEPCO more than $6.7 million in fuel expenditures. In December 1980 NEEI undertook a similar joint-venture with another oil company, investing $53.3 million. At the end of its first year that joint venture was terminated as unproductive.

NEPCO is now converting much of its power generation to coal. NEPCO proposes to enter into long-term contracts for coal supply with independent producers in Virginia, West Virginia, and Pennsylvania, and for rail transportation to coastal ports. The price of purchased coal and its rail transportation is estimated at about 87% of total cost, exclusive of maritime transportation to Massachusetts. For that service, NEEI has entered into a joint venture with an independent shipping firm for construction and operation of a self-unloading collier, which will be chartered by the joint venture to NEPCO for 24-1/2 years.

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The time charter specifies an annual transportation charge that is subject to adjustment annually, and subject to further review at five-year intervals. It includes also provisions for arbitration in case of dispute. The shipping firm, the partner in the joint venture, had no interest in a management contract, nor in a profit that represented a utility rate of return. NEES requested, and the Commission granted an exception from cost under Section 13(b) (HCAR No. 22309). The Commission noted that the terms of the charter, not a arm's-length transaction, was not the final answer as to price. NEPCO's rates were subject to the jurisdiction of the Federal Energy Regulatory Commission under the Federal Power Act. That agency will ultimately determine how much in revenues it will allow, as a cost of transportation, in rates charged to NEPCO's wholesale customers, principally the NEES distribution companies. It may allow the amount computed under the charter between the parties, or some other amount, whatever is just and reasonable.

In the 11-year period 1971-1981 expenditures for fuel and related facilities by registered holding companies amounted to about $4.2 billion. Appendix A attached hereto provides the details.

III

Exempt Holding Companies (Section 3(a) and Rule 2)

Section 3(a) of the Act provides exemptions for five classes of holding companies, two of which are pertinent here. Section 3(a)(1) provides an exemption for a holding company if it and its public

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utility subsidiaries are organized in the same state and carry on the utility business substantially in that state. Section 3(a)(2) exempts a holding company that is itself predominantly a public utility which operates in the state of its organization and contiguous states, and which, as a holding company, has one or more relatively small utility subsidiaries.

The introductory clause of Section 3(a) provides that the Commission shall exempt a holding company that meets the statutory criteria "from any provisions or provisions" of the Act "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers . . ." This permits the Commission to exempt the holding company from some but not all provisions of the Act, depending upon its findings under the "unless and except" clause. An exemption may be qualified or subject to conditions or, in a particular case, denied altogether. In addition, Section 3(c) provides that the Commission shall revoke an order of exemption if it finds "the circumstances which gave rise to the issuance of such order no longer exist."

Section 3(a) authorizes the Commission to grant exemptions by order. Under the Act an order is preceded by an application, which is followed by a notice of filing that gives interested persons a right to appear, to object and to request a hearing. In any proceeding, a state commission has an absolute right to intervene and be heard. On expiration of the notice period, or after a hearing, an order is issued. Section 3(c) provides that if an application is filed in good

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faith, meaning that a prima facie claim for the exemption is stated, the holding company is exempt pending final action by Commission order.

Section 3(a) also provides that an exemption may be granted by rule. Rule 2 under the Act (17 CFR §250.2) provides that a holding company claiming an exemption under Sections 3(a)(1) or 3(a)(2) need not file a formal application for an order. Instead the company may file a statement claiming the exemption, which, if in good faith, exempts the holding company. No notice is published and no order is issued. The statement must be renewed each year, accompanied by financial statements for the holding company and the utility subsidiaries. Rule 6 (17 CFR §250.6) provides that an exemption under Rule 2 may be terminated by a letter from the Commission stating that questions exist concerning the holding company's exempt status. In that event, the holding company has 30 days to respond. It may either register as a holding company or file a formal application for exemption, which, if in good faith, exempts the holding company until the Commission issues an order concerning the exemption. Rule 6 is based upon Section 3(c), which authorizes the Commission to revoke an exemption previously granted if conditions have subsequently changed.

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Rule 2 is an effective administrative technique. It permits the holding company to secure the exemption promptly, if the filed statement is in good faith, without a formal application, notice and order. The annual renewal of the exemption permits periodic review of the holding company's exempt status in terms of the public interest and interest of investors or consumers on the basis of actual developments rather than by imposition of conditions at the outset when the holding company is first organized.

Challenges to a holding company's exempt status have been rare. Proceedings were initiated to test the extent to which Section 11(b) applied to exempt holding companies. The two cases were Pacific Lighting Corp. and National Utilities & Industries Corp.* It was no accident that the two cases involved gas companies. This was in an era of perceived declining gas reserves and limited construction needs, so some gas companies began diversifying into other businesses. After the Penn Central collapse, it seemed an appropriate time to consider the extent to which operations of a regulated gas distribution company may be combined with unregulated businesses under a holding company in light of Section 11(b)(1).

In a 1936 order the Commission had granted Pacific Lighting an exemption as an intrastate holding company. Its four utility subsidiaries (thereafter consolidated) were engaged in the retail distribution of natural gas in southern and central California. It subsequently organized other subsidiaries to engage in utility related

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* 45 SEC 152 (1973) and 45 SEC 167 (1973).

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ventures. In 1969 it initiated a program of acquisitions of companies wholly unrelated to its gas utility business. These included real estate subsidiaries in California and Hawaii and others engaged in farming and marketing citrus fruits and pistachio nuts. The diversification program was completed in 1971. Its non-utility related assets comprised about 14% of its total assets. In 1969 National Utilities was organized as a holding company over Elizabethtown Gas Company, a small gas utility in New Jersey. Its non-utility subsidiaries included investments in a commuter airline, a travel agency and a data processing firm. Its non-utility assets were about 9% of total assets.

National had claimed an exemption under Rule 2, but when notified of its termination, National applied for an order under Section 3(a)(1). Hearings were ordered, which commenced June 15, 1971 and concluded July 13, 1971. With respect to Pacific Lighting, the Commission, on August 13, 1971, ordered a hearing to determine whether its exemption shold be revoked or modified. Hearings commenced November 22, 1971, and concluded January 24, 1972.

Two commissioners substantially agreed with staff's position, holding that non-utility activities should be complementary to the utility business. The two other commissioners held that Section 11(b)(1) applied strictly only to a registered holding company. They agreed, however, that "adverse consequences" could result from diversification, and stated that under the "unless and except" clause the Commission was required to prevent "undue risks to investors and

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consumers" from expansion into non-utility businesses. They suggested guidelines. Departure from them "would, at least presumptively, warrant an adverse finding under the 'unless and except' clause." Among the suggested limits were (1) that the non-utility ventures be in separate corporations and (2) that they be relatively modest in terms of the entire system, so that the utility business would remain the predominant business of the holding company system, thereby minimizing the extent of the risks to the utility from financial reverses of the non-utility ventures. The effect of the 2-2 vote was to permit Pacific Lighting's order of exemption to continue. National has remained an exempt holding company on the basis of its application under Section 3(a)(1), and later disposed of its investments in the travel agency and the commuter airline.

Since these two 1973 decisions, the Commission has not further defined the extent of diversification permitted exempt holding companies under the "unless and except" clause. Holding companies organized since then with an interest in diversification have claimed exemptions pursuant to Rule 2. The claim to exemption is considered made in good faith, since it is not assumed that the guidelines will be exceeded, that the holding company will be imprudent in its financing, or that non-utility ventures are destined to fail.

A special situation was presented when Lykes Bros., Inc., acquired the stock of Peoples Gas System, Inc. in 1976. Lykes was a Florida corporation engaged in food processing, cattle ranching and banking. Its non-utility investments far exceeded the investment in Peoples, a natural gas distributor in Florida. A neighboring utility,

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Florida Gas Company, had been interested in acquiring Peoples for stock, but Lykes offered cash which the controlling stockholders of Peoples preferred. Lykes claimed exemption under Rule 2, which was terminated under Rule 6. Lykes thereupon filed a formal application for an order under Section 3(a)(1). Briefs were filed, with staff urging that Lykes be granted an exemption on condition that it dispose of Peoples. Lykes agreed to a divestiture under a plan, which the Commission approved, providing for the distribution of Peoples stock to stockholders of Lykes (HCAR Nos. 20487 and 20570). Subsequently a conglomerate acquired control of Florida Gas Transmission, a pipeline subsidiary of Florida Gas, and Peoples acquired the retail properties of Florida Gas.

The only other case of termination of a Rule 2 exemption involved Colonial Gas Energy System, a small holding company with two retail gas subsidiaries in Massachusetts. It had claimed exemption under Rule 2 for many years prior to September 9, 1977, on which date its claimed exemption was terminated because of the deteriorated financial condition of Colonial and its subsidiaries. In 1977 the consolidated system's capitalization included 23% short-term debt and only 18% common equity, and the utility subsidiaries were not able to sell bonds for want of sufficient common equity which Colonial was unable to provide. Thereafter the staff worked with Colonial to develop financing plans. Colonial agreed that the holding company was really not necessary, and the Commission approved Colonial's plan to merge the holding company with its operating subsidiaries (HCAR No. 22144).

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Today there are 91 holding companies exempt under Sections 3(a)(1) and 3(a)(2). Twenty-five are exempt by order, and 66 are exempt pursuant to Rule 2. At December 31, 1977, there were 51 holding companies claiming exemption under Rule 2, of which 42 are still extant. Since January 1, 1978, 24 operating utilities created holding companies with claimed exemptions under Rule 2.

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FUEL PROGRAM EXPENDITURES OF REGISTERED HOLDING COMPANY SYSTEMS
(FISCAL 1971—FISCAL 1982)
(IN MILLIONS OF DOLLARS)

Appendix A

Fiscal year expenditures:

1981	=	$1.030 billion
1980	=	$597.9 million
1979	=	$460.6 million
1978	=	$184.0 million
1977	=	$342.0 million
1971-1976	=	$1.586 billion (average per year = $264.3 million)
Total eleven year period	=	$4.2 billion (average per year = 381.8 million)

Approximate
Holding Company Systems Expenditures
1971-1981 Breakdown:

Name of Holding Company	Oil Gas Exploration and Financing	Coal Exploration Development	Coal Mining Expansion	Uranium Exploration	Financed Fuel Oil Inventory	Financed Nuclear Fuel Procurement	Fuel Transportation and Storage	Coal Gasification
American Electric Power Co.	$ —	$515.0 (E)	$555.9 (E)	$ —	$ —	$ 91.0	$ 60.3	$ —
Central and South West Co.	383.4	84.7	—	6.6	—	—	66.1	—
General Public Utilities	—	35.0	—	—	—	—	—	—
Middle South Utilities	436.7	18.0	21.5	24.8	215.2	391.4	139.2	—
New England Electric System	223.2	—	—	—	—	6.0	—	—
Northeast Utilities	—	—	—	—	—	51.0	—	—
Southern Company	—	—	—	—	—	60.0	36.4	—
Columbia Gas System, Inc.	421.2 (E)	—	—	—	—	—	—	25.0
Consolidated Natural Gas	257.0 (E)	—	—	—	—	—	—	13.0
National Fuel Gas System	18.1	—	—	—	—	—	44.3	—
Total 1971-1981 by program =	$1,739.6	$652.7	$577.4	$31.4	$215.2	$599.4	$346.3	$38.0

Total 1971-1981 = $4.2 billion

(E) Estimated

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HOLDING COMPANIES CLAIMING EXEMPTION

FROM THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

PURSUANT TO RULE 2

As of May 15, 1982

Part I — Holding Companies Filing Annual Statements

Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
Alabama-Tennessee Natural Gas Co. Tennessee River Development Co. Four non-utility subsidiaries One inactive subsidiary	Alabama	181	(a)(1)
Alagasco, Inc. Alabama Gas Corporation Three non-utility subsidiaries	Alabama	242	(a)(1)
Alaska Electric Light & Power Co. Haines Light & Power Co., Inc.	Alaska	252	(a)(2)
Alexander & Baldwin, Inc. 1/ Pacific Resources, Inc. Gasco, Inc. Fifty active non-utility subsidiaries	Hawaii	166	(a)(1)
Atlantic City Electric Company Deepwater Operating Company One non-utility subsidiary One inactive subsidiary	New Jersey	3	(a)(2)
Atlantic Utilities Corp. Atlantic Gas Corp. South Florida Natural Gas Co.	Florida	260	(a)(1)
Bangor Hydro-Electric Company Maine Electric Power Company, Inc. Three non-utility subsidiaries Four inactive subsidiaries	Maine	206	(a)(2)
Bay State Gas Company Northern Utilities, Inc. Two non-utility subsidiaries Two inactive subsidiaries	Massachusetts	249	(a)(2)

1/ See also Pacific Resources, Inc., which also claims exemption as a holding company over Gasco, Inc.

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
Bluefield Gas Company Commonwealth Public Service Corp.	West Virginia	153	(a)(2)
Central Illinois Public Service Co. Electric Energy, Inc. One non-utility subsidiary	Illinois	140	(a)(2)
Central Louisiana Electric Co., Inc. CLECO Construction Co., Inc.	Louisiana	257	(a)(1)
Central Louisiana Energy Corp. Trans Louisiana Gas Company Three non-utility subsidiaries	Louisiana	240	(a)(1)
Central Maine Power Company, Inc. Maine Electric Power Co., Inc. Maine Yankee Atomic Power Co. Five non-utility subsidiaries	Maine	198	(a)(2)
Central Vermont Public Service Corp. Central Vermont Pub. Serv. Corp.-Bradford Hydroelectric, Inc. Central Vermont Pub. Serv. Corp.-East Barnet Hydroelectric. Inc. Connecticut Valley Electric Co., Inc. Vermont Electric Power Co., Inc. Vermont Yankee Nuclear Power Corp. One non-utility subsidiary	Vermont	65	(a)(2)
Cincinnati Gas & Electric Co., Inc. Lawrenceburg Gas Company Miami Power Corporation Union Light, Heat & Power Co., The West Harrison Gas & Electric Co., The Three non-utility subsidiaries	Ohio	70	(a)(2)
Commonwealth Edison Company Commonwealth Edison Company of Indiana Six non-utility subsidiaires	Illinois	201	(a)(2)

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
Commonwealth Energy System 1/ Cambridge Electric Light Co. Canal Electric Co. Commonwealth Electric Co. Commonwealth Gas Co. Eight non-utility subsidiaries	Massachusetts	122	(a)(1)
Connecticut Energy Corporation Southern Connecticut Gas Co., The Four non-utility subsidiaries	Connecticut	244	(a)(1)
Consolidated Papers, Inc. Consolidated Water Power Co., Wisconsin River Power Company Nine non-utility subsidiaries	Wisconsin	53	(a)(1)
Cordillera Corporation Utah Gas Service Company Eleven active non-utility subsidiaries	Utah	226	(a)(1)
Crescent Oil, Inc. Union Gas System, Inc. Two non-utility subsidiaries	Kansas	229	(a)(1)
Eastern Gas & Water Investment Company Eastern Shore Gas Company Chestertown Shorgas Company Six non-utility subsidiaries	Maryland	143	(a)(2)
Estacado, Inc. New Mexico Electric Service Co. Hobbs Gas Company Two non-utility subsidiaries	New Mexico	253	(a)(1)
Florida Progress Corp. Florida Power Corp. Six non-utility subsidiaries	Florida	267	(a)(1)
Green Mountain Power Corp. Vermont Electric Power Company, Inc. Vermont Yankee Nuclear Power Corp.	Vermont	197	(a)(2)

1/ Name of holding company changed from New England Gas and Electric Association.

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
Hawaiian Electric Co., Inc. Hawaii Electric Light Co., Inc. Maui Electric Co., Ltd.	Hawaii	200	(a)(2)
Houston Industries, Inc. Houston Lighting & Power Co. Two non-utility subsidiaries	Texas	231	(a)(1)
Illinois Power Company Electric Energy, Inc. Four non-utility subsidiaries Five inactive subsidiaries	Illinois	84	(a)(2)
Indiana Gas Company, Inc. Ohio River Gas Company, Inc. Two non-utility subsidiaries	Indiana	184	(a)(2)
Intermountain Gas Industries, Inc. Intermountain Gas Company Three non-utility subsidiaries	Idaho	245	(a)(1)
Iowa Resources, Inc. Iowa Power and Light Co. Eight non-utility subsidiaries	Iowa	254	(a)(1)
Kentucky Utilities Company Electric Energy, Inc. Old Dominion Power Company	Kentucky	141	(a)(2)
Louisiana Energy & Development Corp. Delta Gas Incorporated Two non-utility subsidiaries	Louisiana	238	(a)(1)
Louisiana General Services, Inc. Louisiana Gas Service Company Seventeen non-utility subsidiaries	Louisiana	211	(a)(1)
Michigan Energy Resources Company Michigan Gas Utilities Company Three non-utility subsidiaries	Michigan	256	(a)(1)
Midwest Bottle Gas Company Midwest Natural Gas, Inc. Twelve non-utility subsidiaries	Wisconsin	188	(a)(1)
Minnesota Power & Light Company Superior Water, Light & Power Company Two non-utility subisidiaries	Minnesota	78	(a)(2)

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
National Gas & Oil Co. National Gas & Oil Corp.	Ohio	262	(a)(1)
New Jersey Resources Corp. New Jersey Natural Gas Co. Two non-utility subsidiaries	New Jersey	265	(a)(1)
Niagara Mohawk Power Corp. Beebee Island Corporation Canadian Niagara Power Co., Ltd. Moreau Manufacturing Corp. St. Lawrence Power Company Three non-utility subsidiaries	New York	93	(a)(2)
NICOR, Inc. Northern Illinois Gas Co. Twenty-one non-utility subsidiaries	Illinois	228	(a)(1)
Oklahoma Gas & Electric Company Arklahoma Corporation, The	Oklahoma	82	(a)(2)
Pacific Resources, Inc. 1/ Gasco, Inc. Thirteen active non-utility subsidiaries	Hawaii	213	(a)(1)
Pennsylvania Enterprises, Inc. Pennsylvania Gas & Water Co. Seven non-utility companies	Pennsylvania	221	(a)(1)
Philadelphia Electric Company Conowingo Power Company Philadelphia Electric Power Co.2/ Susquehanna Electric Company Susquehanna Power Company Five non-utility subsidiaries	Pennsylvania	34	(a)(2)
Primark Corp. Michigan Cosolidated Gas Co. Two non-utility subsidiaries	Michigan	264	(a)(1)

1/ See also Alexander & Baldwin.

2/ A registered holding company.

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule Basis
Providence Energy Corporation Providence Gas Company One non-utility subsidiary	Rhode Island	258	(a)(1)
Public Service Co. of Colorado Cheyenne Light, Fuel & Power Company Home Light and Power Co. Nine non-utility subsidiaries	Colorado	14	(a)(2)
Rupe Investment Corporation Hoosier Gas Company Thirteen non-utility subsidiaries	Indiana	150	(a)(1)
South Carolina Electric & Gas Co. Carolina Natural Gas Corp. Ten non-utility sbusidiaries	South Carolina	268	(a)(1)
Southeastern Michigan Gas Enterprises, Inc. Southeastern Michigan Gas Co. Three non-utility subsidiaries	Michigan	232	(a)(1)
South Jersey Industries, Inc. South Jersey Gas Company Seven non-utility subsidiaries	New Jersey	207	(a)(1)
Southwestern Energy Company Arkansas Western Gas Co. Three non-utility subsidiaries	Arkansas	248	(a)(1)
Southwestern Virginia Energy Industries, Ltd.	See Williams Associates, Inc.		
Tatum Development Corp. Willmut Gas and Oil Co.	Mississippi	266	(a)(1)
TECO Energy Inc. Tampa Electric Co. Eight non-utility subsidiaries	Florida	250	(a)(1)
UNI Investors Corp. Suburban Fuel Gas, Inc., The	Ohio	263	(a)(1)
Valley Resources, Inc. Valley Gas Co. Three non-utility subsidiaries	Rhode Island	251	(a)(1)

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-	Rule 2 Basis
Wanoat Associates	Massachusetts	42	(a)(1)
North Attleboro Gas Co.			
Washington Energy Company	Washington	234	(a)(1)
Washington Natural Gas Co.			
Four non-utility subsidiaries			
West Florida Natural Gas Company	Florida	145	(a)(1)
Gulf Natural Gas Corporation			
Six non-utility subsidiaries			
WICOR, Inc.	Wisconsin	255	(a)(1)
Wisconsin Gas Company			
One non-utility subsidiary			
Williams Associates, Inc.	Virginia	193	(a)(1)
Southwestern Virginia Energy Industries, Ltd.	Virginia	80	(a)(1)
Southwestern Virginia Gas Co.			
Three non-utility subsidiaries			
Williams, E. Pomeroy & Morgan, Maxie Ponita, Trustees	Georgia	210	(a)(1)
Septurb Securities			
Wisconsin Power & Light Company	Wisconsin	90	(a)(2)
South Beloit Water, Gas & Electric Co.			
Wisconsin River Power Company			
Three non-utility subsidiaries			
Wisconsin Public Service Corp.	Wisconsin	35	(a)(2)
Wisconsin River Power Company			
Four non-utility subsidiaries			

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Part II - Holding Companies Which Have Filed Only An Initial Statement

The following public utility companies are subsidiaries of registered holding companies and are also "holding companies" within the meaning of the Act. Each has filed an initial statement under Rule 2, as provided in paragraph (b) of that Rule. All companies here listed are subject to the Act as subsidiary companies of registered holding companies.

Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-
Allegheny Power System, Inc. System		
Monongahela Power Company Allegheny Generating Company	Ohio	269
Ohio Valley Electric Corporation Indiana-Kentucky Electric Corporation	Ohio	110
Potomac Edison Company, The Allegheny Generating Company	Md. and Va.	270
West Penn Power Company Allegheny Generating Company Beech Bottom Power Company, Inc.	Pennsylvania	119
American Electric Power Company, Inc. System		
Appalachian Power Company Central Operating Company Kanawha Valley Power Company Four non-utility subsidiaries One inactive subsidiary	Virginia	95
Ohio Power Company Beech Bottom Power Company Cardinal Operating Company Central Operating Company Four non-utility subsidiaries	Ohio	4
Ohio Valley Electric Corporation Indiana-Kentucky Electric Corporation	Ohio	110
Eastern Utilities Associates System		
Eastern Edison Company Montaup Electric Company	Massachusetts	25

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 69-
General Public Utilities Corporation System		
Pennsylvania Electric Company	Pennsylvania	129
Waverly Electric Light and Power Company, The		
One non-utility subsidiary		
Middle South Utilities, Inc. System		
Arkansas Power & Light Company	Arkansas	86
Arklahoma Corporation, The		
Associated Natural Gas Company		257
New England Electric System		
New England Power Company	Massachusetts	196
Connecticut Yankee Atomic Power Company		
Maine Yankee Atomic Power Company		
Vermont Yankee Nuclear Power Corporation		
Yankee Atomic Electric Company		
Northeast Utilities System		
Connecticut Light & Power Company, The 1/	Connecticut	112
Connecticut Yankee Atomic Power Company		
Yankee Atomic Electric Company		
Four non-utility subsidiaries		
Three inactive subsidiaries		
Holyoke Water Power Company	Massachusetts	130
Holyoke Power & Electric Company		
The Southern Company System		
Alabama Power Company	Alabama	97
Southern Electric Generating Company		
One non-utility subsidiary		
Georgia Power Company	Georgia	131
Southern Electric Generating Company		

1/ Also exempt by order under Section 3(a)(2) (HCAR No. 14947 (September 26, 1963)).

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HOLDING COMPANIES EXEMPT UNDER

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 BY ORDER

PURSUANT TO SECTIONS 3(a)(1) AND 3(a)(2)

Part III — Holding Companies Granted Exemption Requests

Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 31-	Section 3 Basis	Holding Company Act Release No. and Date
Baltimore Gas & Electric Co. Safe Harbor Water Power Corp.	Maryland	631	(a)(2)	13086 1-16-56
Cleveland-Cliffs Iron Company Cliffs Electric Service Co. Twenty-one non-utility subsidiaries	Ohio	725	(a)(1)	17543 4-14-72
Crawford Electric Coop., Inc. Gascosage Electric Cooperative Howell-Oregon Electric Coop., Inc. Intercounty Elec. Coop. Laclede Elec. Coop. Se-Ma-No Electric Coop. Webster Electric Coop. Southwest Electric Coop. White River Valley Elec. Coop. Sho-Me Power Corporation	Missouri Missouri Missouri Missouri Missouri Missouri Missouri Missouri Missouri	774	(a)(1)	21615
Eastern Gas & Fuel Associates Boston Gas Company Five non-utility subsidiaries	Massachusetts	164	(a)(1)	12807 2-28-55
Fishers Island Utility Co., Inc. Fishers Island Development Co. Fishers Island Electric Corporation One non-utility subsidiary	New York New York	746	(a)(1)	18563 8-12-74
Indiana Gas & Chemical Corp. Terre Haute Gas Corp. One non-utility subsidiary	Indiana	562	(a)(1)	10028 8-11-50

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 31-	Section 3 Basis	Holding Company Act Release No. and Date
Louisville Gas & Electric Co. Ohio Valley Transmission Corp.	Kentucky	229	(a)(2)	272 6-39-36
Maine Public Service Co. Maine & New Brunswick Electric & Power Co.	Maine	534	(a)(2)	7541 7-3-47
Milliken Industries (as succesor to Monarch Mills) Lockhart Power Co.	South Carolina	26	(a)(1)	426 11-5-36
National Utilities & Industries Corp. 1/ Elizabethtown Gas Co.	New Jersey	706	(c)	45 SEC 167 (1973)
Northern States Power Co. Northern States Power Co. (Wisconsin) Lake Superior District Power Co. Three non-utility subsidiaries	Minnesota	606	(a)(2)	12655 9-16-54 22334 12-23-81
Ohio Edison Company Pennsylvania Power Company Ohio Valley Electric Corporation Indiana-Kentucky Electric Corp.	Ohio	766	(a)(2)	21019 4-26-79
Orange & Rockland Utilities Inc. Rockland Electric Company Pike County Light & Power Co. One non-utility subsidiary	New York	81	(a)(2)	135 3-27-36
Pacific Lighting Corporation Southern California Gas Co. Twenty-two non-utility subsidiaries	California	8	(a)(1)	72 1-13-36 (see also 45 SEC 152 (1973)
Paul Smith's College of Arts & Sciences Paul Smith's Electric Light & Power & Railroad Co.	New York	630	(a)(1)	12992 9-22-55

1/ Exempt under Section 3(c) pursuant to Commission's 2-2 vote on company's exemption application under Section 3(a)(1).

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Name of Holding Company and Utility Subsidiaries	State of Incorporation of Holding Company	File Number 31-	Section 3 Basis	Holding Company Act Release No. and Date
Penn Fuel System, Inc. North Penn Gas Co. Penn Fuel Gas, Inc. and subsidiaries	Pennsylvania	671	(a)(1)	19254 11-25-75
Pennsylvania Power & Light Co. Safe Harbor Water Power Corp. Hershey Electric Company	Pennsylvania	634	(a)(2)	19725 10-22-76 13203 6-18-56
Peoples Gas Company Peoples Gas Light & Coke Co. North Shore Gas Company	Illinois	70-4528	(a)(1)	15929 12-22-67 16233 12-6-68
Rochester Gas & Electric Corp. Canadea Power Company	New York	70-2179	(a)(1)	9296 8-25-49
Tennessee Natural Gas Lines, Inc. Nashville Gas Company	Tennessee	561	(a)(1)	12283 12-28-53
Texas Utilities Company Dallas Power & Light Co. Texas Electric Service Co. Texas Power & Light Company Four non-utility subsidiaries	Texas	566	(a)(1)	9786 4-5-50
TWP Inc. T.W. Phillips Gas & Oil Co. Four non-utility subsidiaries	Pennsylvania	748	(a)(1)	18827 2-24-75
Union Electric Company Missouri Utilities Co. Missouri Power & Light Co. Missouri Edison Co. Electric Energy, Inc. One non-utility subsidiary	Missouri	635	(a)(2)	18368 4-10-74
Washington Gas Light Co. Shenandoah Gas Company Frederick Gas Company, Inc. Hampshire Gas Company Five non-utility subsidiaries	D.C. & Va.	218 699	(a)(2) (a)(2)	1064 2-29-40 16706 5-1-70
Wisconsin Electric Power Co. Wisconsin Natural Gas Co. One non-utility subsidiary	Wisconsin	624	(a)(2)	12917 6-3-55

For further informacion, contact the Division of Corporate Regulation at (202)523-5691.

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TESTIMONY OF BEVIS LONGSTRETH

Mr. LONGSTRETH. I would elaborate on why we did not decide to support amendments to the act but rather suggest its repeal. Briefly, the proposals being considered in the House and the Senate would leave the act's regulatory structure nominally in place while eroding its effective reach, either through questionable distinctions between industry segments or through selective curtailment of the Commission's existing powers.

In short, they would leave the Commission with the appearance of responsibility without the authority to discharge it.

The amendment proposal pending in the House, H.R. 5220, introduced by Congressman Corcoran, and its counterpart in the Senate are supported by a group of exempt holding companies and operating utilities who contend that the 1935 act indirectly limits their freedom to use a holding company structure to diversify their business activities.

Accordingly, this group proposes to expand the categories of holding companies entitled to exemption and, most importantly, to remove the Commission's authority to deny or revoke their exemptions for any reason.

The expanded exemptions would greatly reduce the continued validity of the act by removing the great majority of utility holding companies from the Commission's jurisdiction and encouraging others to reorganize so as to qualify for an unconditional exemption. We also decided not to support the two other amendment proposals which are pending in the Senate but which have not as yet been introduced in the House, possibly because of our actions.

One of these proposals introduced as S. 1871 would redefine the term "public utility holding company" to exclude all three gas utility companies presently registered under the act as well as most exempt gas companies. While this bill has the merit of simplicity, it is not justified by any relevant distinction between gas companies and electric companies. The arguments advanced in support of excluding the gas utility industry from application of the act—and they are effective arguments—are equally valid when used in support of total repeal.

S. 1869, which is supported by most registered electric utility companies, goes beyond the other amendment proposals in its limitation of Commission regulation under the Act. It comes as close as you can to a de facto repeal. S. 1869 would eliminate the requirement of advance Commission review of acquisition of nonutility concerns by a registered holding company and the requirement of advance Commission approval of most types of financing.

It would also remove the Commission's jurisdiction over certain affiliate transactions. This would leave the Commission with little more than limited and unwieldy post hoc powers to order divestiture after an acquisition has been made or other action taken.

Although these industry proposals are motivated by the desire to facilitate greater diversification in the nonutility business, the Commission has concluded there are other reasons why the 1935 act burdens the utility industry in a manner no longer justified by the interests of investors, consumers, or the public. These reasons

have been outlined by Chairman Shad and are explained in detail in our statement.

Accordingly, we believe that the repeal of the act is appropriate at this time and that repeal in contrast to amendment would represent the most effective and responsible legislative response to the issues being addressed here today.

Mr. OTTINGER. Mr. York, why do you think we ought to keep the act, and what concerns the State regulators with respect to their ability to provide the kind of protections the act presently affords?

STATEMENT OF STANLEY YORK

Mr. YORK. If I can use the analogy of the red herring, I would mention two of them mentioned by proponents of appeal. One is that diversification is the issue. It is not. They are in a nonutility business. The question before us is: Is the holding company an appropriate business organizational device for accomplishing purposes that are otherwise perhaps valid?

The second question that has been raised that I would call a red herring is the question of the State's ability to do allocations. We do allocations all the time. We have one utility that serves some territory not too far from Mr. Corcoran's district, which provides electricity, natural gas, and water. We allocate between those. We allocate between States. We do allocations all the time.

The question before the committee, as I understand it, is: Is our ability to do those allocations seriously hampered if the constrictions of the act are taken away and some things happen in the marketplace that then take allocation powers away from us.

You members of the committee are going to face up to some questions on AT&T after awhile, and let me suggest, while it is not an issue in this particular situation, most of the commissioners on State commissions also regulate telephones. We know very well what happens when you try to regulate a piece of a holding company where that holding company operates nationally, has tremendous economic power, can bury you in numbers and statistics and befuddle you with all of the battery of kinds of information that small State regulatory staffs are unable to match.

We know what we are getting into when you take away the kind of restraints that this particular act now lays on utility holding companies.

I would suggest, parenthetically, that I would welcome as an item of proof of sincerity any utility executives who would like to go to my legislature or any of the others and suggest that our staffs be beefed up and our budgets be beefed up, so we can do the appropriate allocation job if this act is repealed.

I have made that offer several times. I have yet to have anyone take me up on it, so I have some question about where that goes in terms of our ability to do allocations when the whole question is broadened.

The law has kept the dangers under control. The real problem that underlay the act was the misuse of economic power created by a Government-granted monopoly franchise and that has not changed.

Pyramiding has been controlled as Chairman Shad pointed out very accurately. That doesn't exist today as the trigger problem, but the underlying problem that allowed pyramiding to happen is still there, and that problem exists for all utilities.

Mr. Nichols suggested the act is discriminatory because it only applies to a few. That is not true at all. It applies to everybody equally. Just because a few people choose to take actions that bring them within the purview of SEC regulation does not mean that the act does not apply equally to all utilities across the Nation.

To use the stop sign analogy from my prepared testimony, just because only a dozen cars choose to use a particular sidestreet does not change the need for the stop sign on that sidestreet, nor the impact on all of the other users of that road on the main street. I think that it is a red herring to suggest it applies only to a very few customers.

Let me suggest if this law is repealed or substantially modified, the States would have to go out and develop substitute legislation on a State-by-State basis, but the problems that are created are interstate in character.

Consider, for example, my situation. If Con Edison Electric Power Co. were to create a holding company chartered in Delaware, or worse still in Bermuda, do I still have the ability—not legal, although that is a serious question, but do I have the staff capability to do the kind of monitoring that is necessary?

Then, let's assume that Bermuda Holding Co. creates a California subsidiary. I have some staff members who have already volunteered to do the auditing under those circumstances, but I have hardly the dollars to permit them to take those kinds of junkets.

So what the repeal of the statute or the extensive modification of it would do is to take away the constraints that allow me to do the kind of regulating and allocating that I have been able to do up this point.

Suggestion was made that utilities in the sixties voluntarily reduced their rates. That is not our experience and I would like to know where it did happen, but I would suggest if the electric utilities did come in voluntarily for the reduction of rates in the sixties, it was only because they knew that the commissions were not far behind, and would be bringing them in anyway, and it would be cheaper to come in themselves than to wait until we brought them in.

Exactly my point in relation to the existing law. It is not important to know how many have actually taken advantage of this provision, it is important to know that the whole industry has acted and reacted in a way that is determined by the law.

The same is true about the comment on the size of the SEC staff. As the chairman pointed out a little bit ago, it is not the size of the staff, it is the existence of the law and the knowledge that a small staff can deal with those specific situations that has led to a rather extensive reorganization of the industry, a reorganization that has dealt with the specific problems, but can in no way take away the underlying problems.

I would point out that the only people who are paraded before you, in terms of the stories about how this isn't going to hurt people, are those who have successfully operated under the law.

You don't hear from the people who had problems and you don't particularly hear from the people who, without the constraints of the law, would inadvisedly jump into non-utility activities and create problems for themselves and for their ratepayers.

The situation that you are faced with is that you are being asked to move out of an existing situation where you know what is happening into an uncharted world that has one substantial difference from the illustrations that Mr. Collins used and others have used during the course of this discussion this morning, and that is you are dealing with a monopoly that has been given a franchise by a governmental entity, a monopoly from which the ratepayer cannot flee, but from which the stockholder can flee if the perception of risk is too high.

Now, the question is, do you remove the protection that that ratepayer has enjoyed, in other words, to make it possible for the stockholder to take further risks? I have absolutely no problem with stockholders taking risks. They can do what they want.

They can vote with their feet, as it were, and I think that is entirely appropriate. The problem is that you are dealing with dollars gained from monopoly ratepayers and the question is how those are used to the stockholders' advantage.

I would strongly urge, both on behalf of most of my colleagues in State regulation, on behalf of my own Commission, and in my behalf, that you don't repeal or substantially modify this act.

[Testimony resumes on p. 691.]

[The prepared statement of Mr. York follows:]

TESTIMONY OF STANLEY YORK, CHAIRMAN, PUBLIC SERVICE COMMISSION OF WISCONSIN

INTRODUCTION

My name is Stanley York. I am the Chairman of the Public Service Commission of Wisconsin and Chairman of the Ad Hoc Committee on Utility Diversification of the National Association of Regulatory Utility Commissioners (NARUC). I appreciate the opportunity to appear before you today to comment on HR 5220, HR 5465 and HR 6134.

As a state regulator it is my responsibility to assure that adequate utility service is available to consumers at just and reasonable rates. The abuses of holding companies which led to the creation of the Public Utility Holding Company Act of 1935 threatened this basic responsibility of regulation. You are now being asked to give consideration to the repeal or significant modification of that law. I believe it is imperative that Congress consider the impact of any changes on the utility ratepayer whose viewpoint has not been widely presented on the discussions of this issue. It is my purpose today to speak for that ratepayer who is significantly threatened by the proposed changes in the existing law.

It is true that the circumstances which led to the original passage of the law have substantially changed. What has not changed is the inherent temptation for a monopoly industry to use its monopoly power for the advantage of its shareholders at the expense of its ratepayers. The fundamental question that you must face is whether a franchised monopoly can be regulated without the existing law in a way that will prohibit that monopoly from forcing its captive customers to pay for benefits going to others.

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The proponents of change would argue that the stop sign should come down because there have been no accidents at this interchange for the last 47 years. I would argue that there have been no accidents because the stop sign has been there. Proponents would argue that the Traffic Department no longer needs to worry because the nature and complexity of the traffic has changed over the years and that the original speed limits and capacities of the vehicles have changed. I would argue that there is every bit as much need for protection from the dangers inherent in the new vehicles as there was in the old, and that it is the protection that we are discussing, not the vehicles. Nobody is suggesting that the danger today is from pyramiding electric utilities. What the proponents forget to mention is that the danger is just as real from the misuse of monopoly power because of the tremendous pressures to use that monopoly power to the disadvantage of the monopoly ratepayer.

Can I tell you how many abuses there will be when the stop sign is taken down? No, I cannot, anymore than the traffic engineer can tell you how many accidents there will be when the stop sign is removed from the dangerous interchange. All he can tell you is that people using that interchange will suffer injury and death. I'm not sure government even has the right to give a franchise that creates a monopoly if it does not at the same time protect the customer of that franchise from abuse.

Advocates of repeal or modification of the Act have put forth several arguments. I urge the Committee to scrutinize each of these arguments and its underlying assumptions very carefully.

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States Will Be Hard Pressed To Take On
Additional Regulatory Burdens

Advocates of repeal or modification of the Public Utility Holding Company Act argue that it is all right to repeal federal regulation in this area because other forms of regulation, including state public service and security commissions, are there to handle the difficulties. It is argued that the present regulation is duplicative and that there is no longer any need for the SEC to be involved. Such statements fly in the face of the reality that we experience at the state level.

It is quite apparent that, with the existing law, states in fact are able to monitor kinds of activities that are permitted under the existing law. If you take that law away you will put states in the position of having to review the economic and financial activities of holding companies which may be located a half a continent away from the state commission charged with monitoring its activities. State securities commissions are charged with the protection of stockholders. No one has suggested in any way that stockholders are in jeopardy with the repeal of the Act. We're discussing here the jeopardy of monopoly ratepayers.

Even if states had the statutory authority to monitor the allocation procedures and cross-subsidization possibilities of a foreign holding company, it is highly questionable whether they have either the numbers of staff or the staff expertise to carry out that responsibility. It is easy for the proponents of repeal to tell you that you should rely on the state commissions. They fail, however, to mention that in the real world the state commissions

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do not have the capability to carry out the functions of the existing Act.

I would call to your attention what state regulators have had to say on this issue. In 1972 NARUC issued the Swidler Report, which reviewed the subject of utility diversification and indicated a need to strengthen the controls over public utility diversification at both the state and federal levels because of the potential for abuse. That potential is inherent in the monopoly nature of these industries and does not change over time. The NARUC Executive Committee more recently has concluded that "the contemplated changes in the Act (PUHCA) may seriously jeopardize the ability of state commissions to regulate these utilities."

Third, there is also concern about the jurisdiction of states when a holding company operates across state lines. Fourth, some states simply do not have the legislative authority, even within their own boundaries, to review affiliated interests. Fifth, state regulatory commissions have severe workload constraints that are getting worse. In Wisconsin we regulate over 900 utilities with a staff of 150 people. As we attempt the task of assuring adequate service at just and reasonable rates, we are also dealing with irate consumers, the deregulation of natural gas, the divestiture of parts of AT&T, and a myriad of other issues. We have about 400 pending cases on any given day and have recently experienced a six percent cut in our budget, as well as the required layoff of a number of employees. That does not leave us much in the way of resources to fill in in an area where the federal government may pull out.

Proponents have also argued that since state commissions control the rate of return, the hearts and minds of utilities will follow state

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commission desires. It seems to me this is a very poor basis on which to premise regulation. There is no substance to the clout of rate of return regulation unless, and until, the staff is able to do appropriate research and analysis,and commissions are able to wield that club judiciously.

The argument that state commissions can exercise the jurisdiction that has been the responsibility of the SEC simply does not stand up.

HR 6134 Says that Congress will be Able to Fill the Gap Using its Oversight Function

HR 6134 provides some comfort in the following quotation: "(4) the Congress, through appropriate oversight activities, can review the activities of Federal and State regulatory agencies to assure that the interests of investors and consumers are adequately protected and can take appropriate action to supplement those authorities should such action be determined to be necessary or appropriate." I would submit that the only review that is adequate to assure that those interests are adequately protected is intensive and in depth auditing. Congress is hardly prepared to audit each utility that goes into a diversified situation and make a determination that that activity is appropriately carried out and in the public interest. That is precisely why Congress has created regulatory bodies like the SEC, and exactly the kind of task that has been delegated to such regulatory bodies. The premise of the quotation is exactly correct: that it is necessary to review these activities to assure that the interests of consumers are adequately protected. The mechanism proposed is nonsensical. How can Congress,through the exercise of its oversight function, determine whether or not there is cross-subsidization

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going on with the ratepayers of Wisconsin Electric Power Company to the stockholders of Wisconsin Electric Power Company. You have your hands full with determining national policy; you are hardly about to get into the auditing of particular utilities.

The Financial Benefits of Repeal are Suspect

The proponents have argued that repeal of the Public Utility Holding Company Act will enable utilities to improve their overall financial condition, reduce capital costs, and reduce the risk of their operations. In response to this contention I would call to the Committee's attention the consensus view of investment counselors that diversification should not be undertaken by utilities which are having financial problems. Diversification is a recommended activity only for those who have a good cash position today or have every reason to expect that their cash position will be excellent in the near future. All of the analysts with whom I have talked have vigorously recommended that utilities with financial problems stay out of diversification.

The Committee might also want to look at the question of whether this proposed cure does not come after the patient is already getting well. Increasingly we hear from the financial experts that as construction programs are completed, utility stocks will again be a good buy. Authorized rates of return have been increased substantially in the last 12 months, and the "financial plight" cry may soon be substantially diminished.

Proponents of repeal use the fear of future shortages of electricity as a reason to accept their arguments. In many parts of the country reserve margins are triple that which is needed and construction demands in the future

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have to do with decreasing dependence on imported oil rather than providing a bare minimum of reserve.

It is possible that diversification can decrease the capital costs of utilities, but the possibility is equally great that this activity can increase those costs. If the restraints of PUHCA are removed, it is highly likely that utilities that have no business diversifying will succumb to the temptation and the good record of utilities under PUHCA will be wiped out. It is clear that under some circumstances a diversity of risk within a portfolio can decrease the overall risk of the portfolio. That discussion, however, has to do with the utility stockholder, not the monopoly ratepayer. It is the ratepayer who deserves the protection from a government created franchised monopoly.

It is also argued that the money to be spent on diversified activities is the money of the stockholder from retained earnings and should be of no concern to a regulator for the utility ratepayer. That argument misses the point that those retained earnings have in the past been available to the ratepayer through reinvestments in utility construction programs, and that the shock of losing them could be very painful in the specific rates to be paid. The retained earnings do indeed belong to the stockholder, but just as stability in revenues is something for which the stockholder argues, so stability in rates is also a right of the ratepayer.

It is clear that if a diversification venture succeeds, the stockholder will benefit, and if there is no cross-subsidization the ratepayer is not penalized. If on the other hand the new venture fails, the stockholder has

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assumed some risk and may be penalized, but any risk borne by the ratepayer has been involuntary and the ratepayer may also pay an involuntary penalty. It seems to me very unfair that monopoly ratepayers bear that risk of penalty and yet stand to gain very little if the risk succeeds.

Diversification Does Not Lead to Better Utility Management

The proponents argue that if utilities are permitted to diversify they will be able to attract and retain better management. That argument is grossly misleading. It certainly is true that diversification will attract different kinds of managers to the diversified activities. There is absolutely no indication that those different managers will be better than existing utility management, or that those new managers coming in will devote any of their talents to the utility aspect of the business. The whole discussion centers around bringing in those bright managers who are looking for risky businesses that are the wave of the future. I have not heard anyone describe utilities in that fashion. I don't understand how anyone can presume that any training these people have in unregulated businesses is going to help them in utility management. The argument is simply meaningless.

The Need for the Act Remains Even Though the Trigger Cause of the Original Passage of the Act Does not Loom on our Horizon

The proponents of repeal suggest that because we do not have pyramiding of utilities today there is no longer a need for the act. That argument misses the whole point that, if monopolies of any kind are not constrained, they will use their monopoly power to the detriment of those who must use their services.

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When government grants the franchise that creates the monopoly, it becomes incumbent upon that government to protect those who will otherwise be abused by it. The misuse of the economic power created by the monopoly is inherent in the creation of the monopoly and not dependent on any particular manifestations of abuse. Just because pyramiding is not the problem today does not mean that the purpose of the Act, which was to control the unfettered economic power of the utility, is any different today.

My earlier analogy about the stop sign applies directly to this argument.

The Municipal Utilities Recognize the Dangers

The municipal utilities make a strong case for the retention of the Public Utility Holding Company Act. They have demonstrated in at least two different cases the value of the Act as it presently exists. In one case the American Electric Power Company (AEPC) petitioned the SEC regarding the acquisition of the Columbus and Southern Ohio Electric Company. The SEC recognized that the municipal utilities were vulnerable because this acquisition would further concentrate the wholesale electric supply for Ohio. Conditions were set which would prevent the company from abusing this extended monopoly position. In another case the municipals were successful in getting participation in an effort on the part of the New England investor-owned utilities to acquire two nuclear generating stations. In both of these cases it was obvious that the acquisition review authority of the SEC is critical to avoid monopoly supply situations from occurring. Unfortunately, many states do not have the authority within their statutes to prevent this sort of activity, and when

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the acquisition extends beyond state boundaries, state statutes are limited in their ability to deal with this situation.

The Present Law is Not too Burdensome

Proponents of repeal would argue that the present law is too cumbersome and burdensome for utilities. I would suggest, however, that the Committee look at the successful use of the law by a number of utilities, who may not like the hoops through which they have to jump, that have successfully entered diversification activities. If I were head of a monopoly I, too, would argue against jumping through hoops. But as a representative of the ratepayer of that monopoly I would suggest that the price of hoop jumping is small compared to the value of holding the monopoly franchise. I would argue that the present law has all the flexibility that holding companies need. The Act does require utilities to do significant planning, but has not prevented them from making acquisitions that are consistent with their purposes as utilities.

I think it can be argued that the creation of a holding company is an effort to escape regulation. While deregulation is now the vogue where there is serious potential for competition, I would urge the Committee to ask just how real the possibility of competition is for the monopoly ratepayer today. The price demanded by the present law may in fact be high, but it is not out of proportion to benefits granted by the franchise.

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Conclusion

State commissions have relied upon the existing law and continue to do so. The voices for change and repeal come, not from those with the responsibility of protecting the ratepayer, but from the utilities themselves, and from regulators whose responsibilities lie in a different direction. One would not expect the SEC to understand the ratepayer implications of repeal in the same way that they would understand stockholder implications. That is not their task. For them to suggest repeal is not unlike the foxes' lawyer suggesting that it is no longer necessary to lock the chicken house. To repeal or substantially modify the Act is to put ratepayers in jeopardy because existing state laws and state regulators have relied on that law and have not seen a need to duplicate it at the state level. To suggest that no one will be hurt by its repeal is to say that monopolies will be nice and will look after the needs of their ratepayers without constraint. But such logic flies in the face of everything you and I know about economic reality. I strongly urge that you do not modify or repeal the Act.

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Mr. OTTINGER. What would be the motive for a utility to want to get involved in an interstate holding company? Is it not entirely possible that the real push for this is to get outside of effective State control?

Do they set up holding companies so State regulation would no longer be an effective protection to the utility consumer?

Mr. YORK. I don't think there is any question about that. Yes. The financial people have consistently said that the utilities with financial difficulties should not look at diversification as a way out of them. Diversification is a valid economic activity only for the utility that is in a good cash position today or expects to be in a good cash position tomorrow.

Mr. OTTINGER. If that takes place within your State, you can adequately regulate and see that there is no cross-subsidization. You are saying, if you are faced with the large interstate company with numerous opportunities for cross-subsidization throughout the country, you have no resources to be able to track that and make sure your ratepayers aren't being forced to help finance unsound ventures someplace else?

Mr. YORK. That is correct, and as it moves steps away from us or as the utility becomes a smaller proportion of the total business of the holding company, then I lose the ability to deal with the monopoly problems of the utility in progressive fashion—I was going to say in proportion to that distance, but it is probably geometric rather than arithmetic.

Mr. CORCORAN. Would the chairman yield on that point?

Mr. OTTINGER. I will be glad to yield.

Mr. CORCORAN. I hesitate to inform a State regulator about his or her business, but I would just point out for the record there have been a number of cases on the reach of the State Public Utility Commissions on these matters.

Back in the testimony of the Chairman of the Securities and Exchange Commission, he points to the *Western Distributing Co.* vs *Public Service Commission,* Supreme Court decision, 1932, and the Supreme Court decision in 1937 involving a natural gas pipeline company versus *Slattery,* which very clearly, pursuant to the 1935 act and subsequent securities legislation, give the State regulators the authority, whether on affiliate transactions or in other circumstances, to get all of the information that the Commission needs in terms of what is happening with that utility company, which may, in fact, be headquartered in some other State, but in terms of the impact on, in your case the State of Wisconsin, I would suggest that the law is quite clear, judicial decisions certainly support the notion that you have that authority.

And I think there are a number of other ways which have been expanded on considerably in the course of this hearing which would give the State regulators access to the information that they need in order to protect the ratepayers, which is their primary responsibility as well as the investors.

Mr. YORK. I am not familiar with either of those cases, and I have not seen the chairman's testimony, so I can't respond to that, but I would say this: That State regulators are also bound by their own State laws.

We may have authority to do something under a Federal statute that by action of our own statutes we do not have the authority to do. One of the things upon which State regulators have relied in regard to this particular act is the ability to make affiliated-interest type comments to the SEC, even when that State did not have jurisdiction to make those comments as a State regulatory agency.

They were in essence private citizens acting in an official capacity in doing that. And so, if you take this away from us, then whatever the ability to get information is, the State may well not have the jurisdiction to do anything about the information after it has received it. That is a very large part of my concern.

Only 36 States, according to a recent survey conducted by the NARUC have the ability to deal with the affiliated-interest question. Some of them have pervasively regulated in this area, as in my State—we have a very strong affiliated-interest statute—but in some of that 36, it is having only the ability to get some information, to have some reporting and very little statutory ability to do anything about it, and it is the effectiveness of either the staff resources or the legal jurisdiction to take action that causes the problem.

Mr. COLLINS. Would the gentleman yield?

Mr. CORCORAN. The chairman has the time, but let me comment from a constitutional standpoint, I think it is clear that you have, from the standpoint of the State public utility commissions, the authority to get this kind of information and finally, from a very practical standpoint, the club that you have in the end is that you control the ratemaking authority.

So, if there is a problem about getting the kind of information that you want, which I would submit there is not, based on my understanding of these court cases, and also my understanding of the other public documents that are filed pursuant to the 1933 act and 1934 act, which provide all kinds of information, on a regular basis, I would say, there is nothing going to be hidden from a State regulatory agency.

It may be that they do not have the will to do what is necessary to protect the public interest, but I don't think, from our standpoint, that ought to be the major question in examining this Holding Company Act.

Mr. YORK. Part of the problem is that the information that may be developed that way may be fought by the utility. We have a standard of substantial evidence in the record that we have to meet, and we often have a very serious problem. The utilities are not loath at all to take us to court, saying, "You didn't prove that," so that just having information, where you can't verify and cross-check and come at it in a variety of regulatory ways, is often not sufficient to do the task.

Mr. OTTINGER. It is one thing to have the authority, the other thing is to have the resources, the ability to carry out that authority. While your Commission might be very well staffed, I take it there are many Commissions which would not be equipped.

Mr. Shad?

Mr. SHAD. Last year, our staff conducted one audit. So we are not doing that, either. The implication is, suddenly there is going to be a massive change. We are not doing it, either.

Mr. OTTINGER. It is the act which is doing it. The thing which concerns us is if we repeal this act, there will be a complete array of new holding companies.

Mr. SHAD. I would submit that is not necessarily undesirable. I think that that is the best way to regulate ancillary activities. So that, in fact, you have clean statements. You have a clear division in consolidating, as distinct from consolidated statements. It isn't that complicated to find what activities are going on if they are done in separate compartments. It is much more difficult if an operating utility sets up a division using its own people and its own resources to engage in another activity. Yet, that is permitted today, and that is going on and the States are regulating it. The act does not address that.

Mr. OTTINGER. That is going intrastate.

Mr. SHAD. If an operating utility sets up a division to engage in other activities, it is much more difficult to account for the use of personnel and money and resources than if it is done through a holding company.

I think that throughout these discussions, there is sort of a dichotomy between the interests of investors and consumers. Mr. York would say, "The investor can sell his stock and be gone." They have, in my mind, an enormous identify of interest.

Mr. Levy has pointed out that 30 to 40 percent of the equity capital of the operating utilities comes from the holding companies. Now, when these holding companies have stock selling at deep discounts from underlying book values and are being forced to sell more and dilute that stock, this is clearly not in the best interests of the consumers.

This is clearly not in the best interests of the operating utilities who need that equity capital, and what we are proposing is to afford these companies the same alternatives that are available to virtually all other companies in the United States.

For the sins of half a century ago these companies are being discriminated against today. Once you get this law on the books, it is awfully hard to remove it, but this is the circumstance these 12 holding companies find themselves in.

Mr. OTTINGER. It is the continuing sins we are worrying about.

Mr. YORK. We are not talking about sins, at all. We are talking about when you create a monopoly. Incidentally, I am a clergyman, so I claim some expertise in that area by experience as well as training.

Mr. SHAD. That is calling on higher authority.

Mr. YORK. What we are talking about is the inherent characteristic of a monopoly engaged in nonmonopoly business to want to subsidize the monopoly business with monopoly earnings and all we are looking for is the ability to protect against that.

The question is not at all a comparison of electric and gas utilities with business in general. That is a totally inappropriate comparison at the level of a franchised monopoly. It is a very appropriate comparison in the nonutility aspects and I would say that the nonutility parts of it present a very different argument.

I am talking about the use of monopoly earnings for, and monopoly characteristics that encourage cross-subsidy. That is the thing we are talking about.

Mr. OTTINGER. Let me recognize my two colleagues, and then I think we will wrap up.

Mr. COLLINS. I just want to get two or three points, and I appreciate the gentleman from Wisconsin coming. How big is your department?

Mr. YORK. We have a staff of 150 people regulating 900 utilities.

Mr. COLLINS. You realize the SEC only has 20 people?

Mr. SHAD. It is actually 17, sir.

Mr. YORK. They do a marvelous job.

Mr. COLLINS. You run a good shop down there, Mr. Levy.

Do you know where we come from—we think States can do everything better than it can be done up here in Washington. Why are you opposed to this concept? As I understand it in Wisconsin 10 years ago these big electric companies came out from under it, and you are supervising them now.

Are you having any problem supervising electric companies now operating under you?

Mr. YORK. You put quite a choice before me. In the sense that you are asking the question, no.

Mr. COLLINS. You are doing a good job of it, aren't you?

Mr. YORK. I think so, and by the way, if you would write a letter of reference—earlier, you indicated if we are alert—I have some people back home who don't believe that.

Mr. COLLINS. Don't you believe you can do a better job than they can here?

Mr. YORK. Regulating utilities, yes. Controlling the interstate characteristics of the spread of a holding company, no, that is an interstate thing.

Mr. COLLINS. What is it they can do——

Mr. YORK. It is not what their staff can do, it is what the law does. It is the existence of the act. It is not the staff. The staff monitors, the staff deals with applications, the staff does that sort of thing. It is the act that constrains, the practices that then would get beyond my control if the law were removed.

Mr. COLLINS. One other question I would like to ask.

You are the chairman of an ad hoc committee?

Mr. YORK. Yes.

Mr. COLLINS. Are you speaking for the committee or just your own personal opinions?

Mr. YORK. I was asked to appear here on behalf of NARUC, as a national organization. I am not speaking for the committee, per se. I am speaking for myself, also.

Mr. COLLINS. I have a lot more confidence in you, and I think you can do a great job back there, and I think you are just modest about what you can do in Wisconsin.

Mr. YORK. I am not known for my modesty.

Mr. OTTINGER. Mr. Corcoran?

Mr. CORCORAN. Thank you, Mr. Chairman.

I realize we want to conclude this before our vote in the House of Representatives, so I will be very brief.

I did want to dwell for just a moment on the representations of Mr. York because the hearing schedule indicates that you are appearing on behalf of the National Association of Regulatory Utility Commissioners and, of course, that is not correct.

Mr. YORK. That is correct.

Mr. CORCORAN. I am told that the official testimony of NARUC was presented in the Senate yesterday and it was presented by Commissioner Schuler of New York.

Mr. YORK. Schuler.

Mr. CORCORAN. He indicated that the utility commissions are divided on the repeal or any modification of the Public Utility Holding Company Act and they may want changes in the act.

Second, the executive committee of NARUC and the Ad Hoc Study Committee has taken no position on reforming the Public Utility Holding Company Act and so, I think there is something of a misrepresentation here, and I want that to be clarified.

Third—I say this with some intensity, but in connection with my legislation, I sent a questionnaire to all of the 50 States' public utility commissions, as well as to 140 of the utility companies themselves, and I can tell you that the findings of that questionnaire, which related to a 40-percent response rate, are far different from what you recommend here today, and I would just cite, for example, what we heard from the State of Arkansas, and in terms of their comments, and I quote, "Positive—diversification might help solve current financial problems," and the next date is Florida, and they have some concerns about cross-subsidization which have concerned me and have concerned the witnesses here today as well as our committee, and I could go on and on.

That is a positive position on my bill although implied concern again about cross-subsidization.

I think other witnesses earlier in the day were somewhat misled, referring to what NARUC was going to say and what NARUC was going to have to say on each of these points.

It is a matter of some concern to me that there has been a misrepresentation.

I understand your point of view. I am surprised that a man who was involved with the Republican Party in Wisconsin, is now apparently against the New Federalism or some facsimile thereof, but that is certainly your right.

That is our process, but I do think that it should be clear for the record that the people who are involved as State regulators across this country are quite divided on this question.

Mr. YORK. May I respond? Let me respond several ways. First of all, let me say the past tense with regard to the Republican Party is not correct. It is present tense. I am very strong supporter of the States doing what the States can do best and the Feds doing the rest, and it seems to me that what we have here is an excellent example of a State-Federal balance.

There are some things that we can do that the Feds cannot do as well, and I would be happy to have you transfer wholesale regulation from FERC to us. I think we can do that, but this particular instance is a case where you are dealing with an interstate activity that gets beyond the bounds of our ability to deal with it.

In terms of the question of our commissioners divided, commissioners are divided on all questions. There is no question on which there is unanimity of opinion by commissioners, and if anything that I said represented something to the contrary, then I misspoke.

NARUC commissioners have taken the position generally that they are not opposed to diversification.

They have serious problems with it, and there is a variety of points of view.

Let me also say in regard to the questionnaire that the Congressman distributed, that was distributed very early in all of this discussion. The discussion has developed for 6 months since that time, and a number of people who answered that questionnaire on the basis of past impressions are not now taking the same position, so I think it misrepresents the situation to say that States are in some way represented by that questionnaire.

The executive committee of NARUC has not acted and will not act until July 29, and nothing that I have said is intended to change that. I was invited to speak to the Senate Committee yesterday on behalf of NARUC. I had a commission meeting that I could not leave. Commissioner Schuler agreed to represent NARUC in my place.

We discussed our testimony. I don't think there is any disagreement between the two of us. What I have said here, I think, represents the majority of commissioners in the country, which is that repeal or extensive revision would cause serious problems for State commissions. I tried very hard not to misrepresent, and I do not feel I have misrepresented my position.

Mr. OTTINGER. We thank all of you for your help to the committee. We will have to adjourn.

[The following information was received:]

environmental
action
foundation

724 Dupont Circle Building
Washington, DC 20036

Board of Directors

Walter Boardman
Gail Harmon
Lenneal Henderson
Katherine Hunnimen
Richard Munson
Jerry Powell

Advisory Board

Harry Caudill
Herman Daly
Michael Frome
John Gofman
LaDonna Harris
Hazel Henderson
Odessa Komer
Sam Love
Amory Lovins
Victor Reuther

Projects

Administration (202) 659-9682
Electric Utilities (202) 659-1130
Waste and Toxic
Substances (202) 296-7570

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON ENERGY AND NATURAL RESOURCES

SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER

STATEMENT OF RICHARD E. MORGAN

Regarding The

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

On Behalf Of

Consumer Energy Council of America

Consumer Federation of America

Environmental Action Foundation

Environmental Action, Inc.

Environmental Policy Center

Friends of the Earth

Natural Resources Defense Council

Nuclear Information and Resource Service

Public Citizen's Critical Mass Energy Project

Sierra Club

Solar Lobby

Union of Concerned Scientists

June 9, 1982

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Mr. Chairman and members of the Subcommittee, the above organizations wish to express their views on the subject of proposed changes in the Public Utility Holding Company Act of 1935. We are 12 separate national environmental and consumer organizations, representing a combined membership of 525,000.

We have joined together to prepare this statement because we are vitally concerned about preserving the Public Utility Holding Company Act. We are strongly opposed to repeal of the Act, which we believe would enable utility holding companies to use their peculiar corporate structures to overcharge consumers and deceive investors.

We believe the Holding Company Act is a well conceived piece of legislation which is as important today as it was 47 years ago. We have yet to see any proposed amendments which would improve on the existing law. In fact, the amendments proposed in the House and the Senate, we believe, would create giant loopholes for holding companies to take advantage of consumers and investors.

The Holding Company Act provides crucial protection to the general public. It prevents utility holding companies from abusing their monopoly privileges. And it keeps them from amassing the tremendous economic and political power which they wielded in the 1920s.

The paper empires, stock swindles, and sweetheart deals which chracterized the utilities of the 20s are largely a thing of the past thanks to the Holding Company Act. But to repeal this law during today's turbulent economic times would be inviting the utilities to abuse their investors and consumers once again.

The utility business in the United States is not a free enterprise; it is a monopoly. In exchange for the privilege of monopoly status, utilities must consent to regulation of their prices and business

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practices. The primary function of utility regulators is to prevent utilities from taking unfair advantage of their monopoly status by overcharging and otherwise abusing their customers.

A holding company is much more than a utility. Besides owning several separate utility companies in different states, a holding company might own a few coal mines, a railroad, and a "service company" which provides planning and engineering services to the other subsidiaries.

Regulation of holding companies poses some thorny questions for state utility commissions. Is a subsidiary utility paying a fair price for coal from a "captive" mine? Are the fees it pays to its service company for engineering services appropriate and necessary? Is the regulated portion of the holding company's business subsidizing other enterprises which must compete in free markets?

The potentials for conflicts of interest in a holding company structure are unending. When a holding company's utility service territories cross state lines, it is virtually impossible to regulate effectively at the state level. Since state regulators do not have access to all of the corporate records of a holding company's non-utility functions, they cannot be expected to protect from possible unfair business practices. Here, the Holding Company Act provides crucial protection by regulating transactions between affiliated companies under one holding company roof.

The possibility of such abuse is not just theoretical. Three major holding companies, American Electric Power, Middle South Utilities, and the Southern Company, each own fuel supply subsidiaries. In 1978, the Federal Energy Regulatory Commission (FERC) found that American Electric's captive coal subsidiaries were charging inflated coal prices to its utility operations resulting in overcharges to consumers. Captive coal abuses are a serious problem according to the FERC, which concluded in a February 1982 study that:

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> "(1) Captive coal prices are on the average significantly higher than non-captive coal prices; (2) captive coal mines appear to be operating less efficiently than comparable non-captive coal mines; and (3) regulation of electric utility affiliated coal operations may be inadequate to assure the efficient management of captive mines and the reasonableness of captive coal prices."

In another example, the State of Illinois, just last month, sued People's Energy Corp., a diversified natural gas holding company, for conspiring to "drain" its utility subsidiaries to finance its profitable non-utility operations. Examples like these suggest that there is plenty of work for the staff at the Securities and Exchange Commission to do in enforcing the Holding Company Act.

State utility commissions are quite candid about their inability to properly regulate giant interstate holding companies. A recent resolution on the Holding Company Act adopted by the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC) states that "many state public utility regulatory commissions rely on provisions of the Act to assist in the effective regulation of electric and gas utilities within their jurisdiction." Under the Holding Company Act, for instance, the Securities and Exchange Commission regulates transactions between subsidiaries of registered holding companies, a power which state regulators lack.

Proponents of changes in the Holding Company Act maintain that the law stands in the way of utility efforts to diversify into non-utility businesses. Such diversification, they argue, can help to ease the financial difficulties experienced by utilities in recent years. The current law, however, does not prohibit all diversification into non-utility endeavors by holding companies. It simply protects investors and consumers from the risks of shaky and inappropriate investments by these utilities. If only federal regulators had had such foresight during the last years of another monopoly, the Penn Central Railroad.

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In addition to regulating diversification by the 12 registered holding companies, the SEC may also look at diversification plans of any of the approximately 80 utilities which have previously been granted exemptions from registering under the Act. These utilities are seeking to amend the law to eliminate any possible federal intervention in their diversification schemes.

We wonder why such an amendment might be necessary. The current provisions give the SEC the right to investigate questionable diversification efforts by exempt holding companies. A company with a solid diversification plan should have nothing to worry about. Perhaps these utilities want to avoid federal intervention if they become overextended in diversified investments.

The potential risks of diversification demand careful oversight by regulators. Speaking on diversification, Don C. Frisbee, Chairman of Pacific Power & Light Co., a heavily diversified utility, has stated:

> "You can make more mistakes in new business . . . (I)t is a path that has more dangers than opportunities because of the difficulties of trying to mix a typical management approach to the highly regulated utility business with the entrepreneurial approach needed in unregulated arenas."

Moreover, as NARUC explains,

> "The stockholders of a utility may win or lose as a result to diversification but the consumer bears the risk of failure without any commensurate participation in the benefits of success."

Advocates of changes in the Holding Company Act argue that diversification may be a partial solution to the electric utilities' recent financial difficulties. But new figures from the industry and Wall Street indicate that this financial crisis is all but over. A

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survey by Ebasco Services indicates that the power companies received $9.5 billion in rate increases last year -- an all-time record. According to the Edison Electric Institute, 97 utilities announced dividend increases last year, and stockholder returns rose from 11.4 percent to 12.6 percent.

Under the Holding Company Act, registered holding companies must comply with strict rules when issuing new securities, and the SEC may block questionable financing schemes. Some utilities argue that the law inhibits creative financing methods needed to raise capital in today's markets. But was it not "creative financing" that caused Samuel Insull's holding company empire to collapse in the 1930s? Fifty years ago, millions of investors and consumers suffered when the questionable financial dealings of the holding companies were exposed, a situation which led to the passage of the Public Utility Holding Company Act.

The repeal of the Holding Company Act would not only free the holding companies to pursue non-utility investments. It would also allow insurance companies, banks, and oil companies to freely go into the utility business, building power plants and other utility facilities. On the surface, this prospect might appear to give existing utilities a healthy dose of competition. That is unlikely, however, since each utility needs a monopoly market to sell its power.

More likely, non-utilities would participate with utilities in joint construction projects. Non-utilities might simply buy out some existing utilities, without the risk of being regulated as holding companies.

Just imagine utilities in your state being owned by Exxon or Mobil. Where would they buy their fuel? And how much would they pay for it?

The current law does not prevent non-utilities from becoming involved in the utility business. But if they choose to make large utility investments, they must face the same type of regulation which

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Congress deemed necessary for any integrated utility holding company. Without these protections, we may see a recurrence of the far flung utility empires of the 1920s.

In conclusion, we believe that the Public Utility Holding Company Act is as important today as it was when it was written almost 50 years ago. This law protects consumers and investors, and it protects the utilities from themselves.

Even slight changes in the Act should not be taken lightly. Solomon Freedman, a 30-year veteran at the SEC, has observed that the Holding Company Act is an "integrated statute" and that altering any section could affect the authority of the entire law.

Citing their alleged financial crisis, the utilities say they must be freed from the restrictions of the Holding Company Act so they can pursue new business opportunities. The growing trend toward utility diversification is all the more reason why we need the Act. As the utilities diversify and find new ways to attract capital, we need these protections to make sure we are not led again down the same path as before.

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LONG ISLAND LIGHTING COMPANY
EXECUTIVE OFFICES: 250 OLD COUNTRY ROAD • MINEOLA, NEW YORK 11501

JOHN J. RUSSELL
VICE PRESIDENT

June 28, 1982

Hon. Richard L. Ottinger,
Chairman
U.S. House of Representatives
Subcommittee on Energy Conservation
and Power of the
Committee on Energy and Commerce
House Office Buildiing Annex No. 2
Washington, D.C. 20515

Dear Congressman Ottinger:

We at the Long Island Lighting Company ("LILCO" or "the Company") were dismayed to learn that LILCO Energy Systems, Inc. ("Energy Systems"), a wholly-owned subsidiary of the Company, became a target for criticism during hearings on the Public Utility Holding Company Act before your Subcommittee on June 9, 1982.

Having testified before you on behalf of the Edison Electric Institute, I know of your Subcommittee's work and your personal interest in getting factual data on the record. Therefore, I decided to write to attempt to get the record straight. As you know, our subsidiary is not subject to the Public Utility Holding Company Act, and, therefore, any discussion of Energy Systems is irrelevant to the proposed repeal or amendment of the Act. However, because the Company does have a petition pending before the New York State Public Service Commission ("PSC" or "the Commission") in PSC Case 28025 for authority to finance its subsidiary, we feel obligated to reply to the major allegations made before your Subcommittee concerning Energy Systems by Messrs. John Krull and Harold Krainin on behalf of the National Association of Plumbing-Heating-Cooling Contractors ("NAPHCC"). As we discuss briefly below, we respectfully submit that those allegations are without merit.

1. Financing of LILCO's subsidiary:

In their prepared statement to the Subcommittee, Messrs. Krainin and Krull contend that "... if LILCO Energy Systems loses money in its operation... (a)ny losses passed on to the parent LILCO will produce a loss in operating funds which the Company will seek to recapture through adjustments in the rate base." (Statement, Attachment at 3).

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The NAPHCC statement is misleading. First, LILCO is confident that Energy Systems will be a successful business endeavor; the evidence in PSC Case 28025 is that Energy Systems will be operating in a market with vast potential and will be doing so in a well-planned and conservative manner. Second, even if the risk of loss or failure of Energy Systems were more than purely speculative, the minimal amount of potential loss could not conceivably adversely affect LILCO's capital costs or credit worthiness. Specifically, LILCO's proposal is that only $1 million be invested in Energy Systems. This is an amount that is so small relative to LILCO's total capital investment, or to the number of shares outstanding, or to its annual earnings, that, even if the $1 million investment turned out to be a 100 percent loss, the effect on LILCO's earnings, book value, and interest coverage would be so small that the effect on LILCO's investors could hardly be noticeable.

Moreover, LILCO will operate its subsidiary so that its ratepayers will be insulated from any risks of loss by Energy Systems. The subsidiary has been established to operate at an arm's length relationship from LILCO; that is, Energy Systems will bear its own total cost of operation which, together with a reasonable profit, will be reflected in its prices. Thus, LILCO ratepayers will not subsidize Energy Systems' operations. Moreover, the past history of PSC in successfully isolating a utility's merchandising and jobbing costs from those operating costs recognized for ratemaking purposes insures that any subsidiary losses will not be passed through to LILCO ratepayers.

2. The LILCO name:

Despite the contentions made on behalf of the NAPHCC, the use of the LILCO name by the Company's subsidiary does not bestow any unfair competitive advantage on the subsidiary. In fact, due to the nature of the competitive market, LILCO Energy Systems, Inc. would labor under a distinct competitive disadvantage if such use did not take place. Specifically, there are only a few businesses now active in the energy conservation business. The record in PSC Case 28025 reveals, for example, that four dealers share three-quarters of the solar energy market. One of those dealers is a subsidiary of a major corporation; that subsidiary uses the parent name and markets energy conservation measures. It certainly appears to LILCO that this market could stand the introduction of a new entrant, especially a new entrant that can offer additional valuable information to the public, is reliable and stable, is wanted by potential customers, and will stimulate the market. If Energy Systems could not use the name "LILCO", its effectiveness would be unfairly limited.

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3. New York Home Insulation and Energy Conservation Act:

The NAPHCC spokesmen also expressed concerns that Energy Systems will have access to information gleaned by LILCO during residential energy audits which its competitors will be denied. Energy Systems will not, in fact, be extended such access.

Pursuant to the New York State Home Insulation and Energy Conservation Act ("HIECA"), LILCO has a responsibility to make energy audits available to its customers. The results of those audits remain with LILCO and the customer and are not available to Energy Systems. To ensure that this policy is enforced, LILCO intends to depend solely on independent contractors to handle all energy audit requests if the PSC approves the Company's petition for financing the subsidiary and Energy Systems resumes operations. Moreover, in accordance with PSC HIECA requirements, LILCO has instructed representatives of the firm conducting the audits, as well as its own personnel, not to recommend any individual installer of conservation measures. These policies will continue to be strictly enforced. Thus, implementation by LILCO of its responsibility under HIECA will not provide Energy Systems with any unfair advantage.

4. Installation of energy conservation measures:

Energy Systems was established by LILCO to market solar water heating systems and high efficiency gas heating equipment. Over the longer term, Energy Systems may market energy products and services resulting from future technological developments which it believes will provide customers with the benefits of energy options that they are seeking.

The NAPHCC spokesmen complained that Energy Systems will install energy conservation measures to the detriment of its competitors; the fear is unfounded. Energy Systems personnel will not install energy conservation measures. The installations requested by potential customers of Energy Systems will be performed by independent subcontractors to Energy Systems--many of whom may be members of the NAPHCC!

In summary, your Subcommittee should be assured that LILCO intends to operate its subsidiary in a competitively fair manner and in accordance with all applicable Federal and State requirements. We believe that the proposed activities of Energy Systems will enhance the market for energy conservation measures and help achieve the Nation's goal of conserving scarce energy sources.

Messrs. Krull and Krainin's allegations are particularly disturbing since I have addressed them all in essentially this same manner in sworn testimony and cross-examinations in NYS PSC Case 28025. Mr. Krull was present during that testimony and Mr. Krainin was one of the cross-examining attorneys.

We respectfully request your indulgence in entering this letter into the record in the proceedings before your Subcommittee concerning amendments to the Public Utility Holding Company Act.

Very truly yours,

John J. Russell

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Statement of
Vince Stanley
of V. J. Stanley, Inc.
Rochester, New York

For The
American Supply Association

Before The
Subcommittee on Energy, Conservation and Power
of the
House Committee on Energy and Commerce

on the Public Utility Holding Company Act
June 14, 1982

Mr. Chairman, My name is Vince Stanley and I am here today speaking on behalf of the New York State Plumbing and Heating Wholesalers and the American Supply Association. I am president of V. J. Stanley, Inc., a specialty plumbing supply house in Rochester, New York. I am also a member of the following organizations:

National Association of Wholesaler/Distributors

National Federation of Independent Business

National Small Business Association

National Family Business Council

National Chamber of Commerce

Rochester Chamber of Commerce

Small Business Council of Rochester

and many trade and technical organizations.

The New York State Plumbing and Heating Wholesalers are one of nine regional organizations which comprise the American Supply Association. ASA is the single, national association representing the plumbing-heating-cooling-piping wholesaler. The 3,000 members are primarily small, family-owned wholesale distribution firms.

My customers are the contractors that install and service plumbing, cooling and heating products and systems, and those institutions which utilize pipes,

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valves and fittings. The range of products which we handle include water heating, solar hot water heating, hydronic heating, water conditioning, controls, and other mechanical products. Failure rate of these contractors is up substantially. Many others are closing shop on their own.

I am here today in opposition to legislation which would amend or repeal the Public Utility Holding Company Act and as a result encourage further utility diversification into the plumbing, heating, cooling and energy conservation supply industry. The American Supply Association believes that to encourage diversification is not in the public interest. Diversification would have an adverse impact on competition in the plumbing, heating, cooling and energy conservation fields. Additionally, it would encourage utilities to diversify into an area where they lack the necessary expertise to function efficiently.

I realize that utilities today are able to diversify to some extent under existing law. However, relaxation or repeal of the restrictions on the use of the holding company structure contained in the PUHCA would further exacerbate an already serious situation.

I would like to take a minute to discuss with the Committee what the role of a wholesaler-distributor-supplier is and specifically who the p-h-c-p wholesaler is. Most people understand the function which the manufacturer, retailer or contractor has in our economic system but few understand the function of the wholesaler.

Wholesalers distribute every conceivable type of consumer and industrial product. The wholesaler purchases goods from manufacturers and sells them to retailers and industrial, institutional, commercial and other users. Wholesalers are predominantly small and medium-sized businesses. In 1981, the wholesale segment of the economy was responsible for $1 trillion in sales.

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The wholesaler is an expert in his commodity field. We are a wholesaler with an unusual amount of knowledge of products, parts and accessories; and an extraordinarily large inventory in our specialized lines. We service what we sell. We guarantee for one year the service on all the products that we sell to our customers - the contractors. We deal primarily with the manufacturer. When the utility enters the supply market, because of their size they can deal directly with the manufacturer and by-pass the supplier.

The p-h-c-p wholesaler is not a big businessman. For example, V. J. Stanley, Inc. has approximately 500 customers. Our volume is $2,735,000.00. We are located in the heart of the Rochester business district. We have eleven regular and one part-time employees. We have fifteen plumbing wholesale competitors; thirteen heating equipment competitors; and eight control competitors.

Competition

We welcome competition in our industry. We urge new businesses to start-up and to compete with us. Competition is healthy for our industry and for the American free enterprise system. The p-h-c-p supply industry has been built through initiative, hard work, the entrepreneurial spirit and fair competition.

However competition is only beneficial when all of the players share commmon attributes. At the local level, when a utility enters the supply and service market, their massive economic advantage subsidized through their rates and their optimal position in the marketplace does not further competition.

I realize that there are those who believe that the utilities would diversify into the "big ticket" items: coal and mineral exploration, petroleum production, computor services, and real estate development. But I believe a utility will move first into those areas which are most convenient and familiar -- for example, the supply and installation of heating, cooling and energy con-

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servation systems and products. The p-h-c-p wholesaler supplier could well be the first victim of unrestricted utility diversification.

We are having to compete with the utilities all of the time. Increasingly, the utilities are marketing and supplying heating, cooling and energy conservation systems and products. Because of the existence of the PUHCA however, utilities must conduct their non-energy producing activities within the geographical bounds of their state and either within their existing utility structure or as a subsidiary operation. Under the present system, we win a few and lose a few. Any removal of the barriers in PUHCA will only serve to aggravate and compound the situation. An immediate removal of these barriers could have a disastrous effect.

The advantage that the utility has is awesome in comparison to the supplier. The utility is a regulated monopoly with a guaranteed rate of return. The utility can rely on its rate base to finance and subsidize outside ventures. The utility's incentive for cross-subsidization is both an attractive one as well as one that has more and more been tolerated and encouraged by regulators and legislators. Financially, without cross-subsidization, the utility would not be able to compete, because the utility's actual costs would make the cost for supply and service to the consumer too high to be practical. Until the local utility went out of the retail business a couple of years ago, we sold Rochester Gas & Electric products for over twenty years. Because of their high overhead, we have learned that their cost to the consumer in almost all cases was higher than the average cost for the same product from heating and plumbing contractors. For example, in the case of water heaters, it would be our estimate that over fifty percent of the water heaters sold by contractors - plumbing and heating - would be anywhere from 5% to 20% lower than the utility for the

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same product. Since they stopped selling on a retail basis, I would estimate that the average price on water heaters sold by contractors would be in the same category, if not a little lower.

As we all know, overhead for small business is substantially lower than utilities - consequently utility prices for labor and material are higher - unless subsidized. Again, in Rochester, installation of hot water heaters sold by utility was performed by subcontractors - plumbers who could install for less cost than utility personnel.

The utility can finance ventures through use of its financial credit available as a regulated monopoly or by direct loans to the venture. Even with all of the financial problems the utilities face today, a million dollars in direct funding or guarantees to a new venture is a drop in the bucket to the utility. I wish I would have had a million dollar grub stake with which to start my business.

If the utility's venture does not succeed, the financial loss is absorbed by the utility's ratepayers. If the venture succeeds, the investors enjoy the profits. In the case of the independent businessman, success or failure is borne by the businessman and maybe his shareholders - usually family and friends.

The utility enjoys a enviable market position with an entree into almost every household in the commmunity. This entree gives the utility first crack at supply and service. A subsidiary which shares the use of the utility's name also enjoys this entree.

The utility is often the first place that homeowners will call for service or information on purchasing end-use equipment. If, for example, the utility is involved in the sale of water heaters and John Q. Public calls the utility for a suggestion on where to purchase a replacement water heater, where do you think he will be referred?

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The utility with its financial resources and convenient monthly billing service can offer the consumer terms on purchases which I can't match. For instance, Wisconsin Power and Light has been selling solar water heater units at $1.00 over cost. Northwest Natural Gas has been selling and installing gas water heaters and providing a $150 rebate.

There is little remaining to protect the p-h-c-p supplier from utility competition. The PUHCA has become the principal protection. Since the Act was passed in 1935, it has served to limit the activities of the utilities to those which are functionally related to producing energy and within the state of operation. The disincentives in the Act to utility diversification have served to restrict the utility to its main task of producing energy and supplying that energy to commercial, industrial and residential users.

The PUHCA has effectively forced the utilities to "diversify" within their existing structure and to deal with the state regulatory commission in this regard. The role of the state regulatory commission has been to protect the public interest--primarily the interest of the ratepayer. The public service commmissions have rarely however addressed the question of competition. In your home state of New York, Congressman Ottinger, a proceeding is pending before the State Public Service Commission on behalf of Long Island Lighting Company. LILCO is petitioning for the authority to create a subsidiary, LILCO Energy Systems and to provide financing or guarantees to LILCO Energy Systems of up to $1,000,000. Although LILCO Energy Systems would be in direct competition with suppliers and contractors, the Commission has determined that the question of competition has no bearing on the proceeding.

While the state regulatory commissions are by no means an absolute protector of the public interest under the PUHCA as evidenced in New York, they at least

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have a role in reviewing diversifications. This role provides at least a forum for the consumer and the small businessman. Repeal of the PUHCA would put many activities of the utility outside the jurisdiction of the state commissions.

There are some who say that the question of competition is addressed under the National Energy Conservation and Policy Act which created the Residential Conservation Service program. NECPA does place restrictions on utility supply and installation of energy conservation systems and products. However, DOE's liberal interpretation of waiver and exemption provisions for utility supply and installation have to a great extent allowed for full utility involvement. Additionally, NECPA statutorily does not deal with such items as gas water heaters and replacement heating equipment to name just two items.

I would point out to the Committee, that the intent of the Congress as evidenced in the legislative history of NECPA was to ensure that small and independent contractors and suppliers would continue to have the ability to compete. I would urge this Committee to keep that intent in mind and to reaffirm that position in any legislation considered.

Our major fear is that a repeal or substantial amending of the PUHCA will result in a scenario such as the following:

> A utility will create a holding company which will in turn create a subsidiary for the supply and service of p-h-c-p products and systems. This subsidiary, while sharing the resources and identity of the utility will be outside the jurisdiction of the state regulators, outside the jurisdiction of the SEC and outside the jurisdiction of the DOE under NECPA. In this situation the small suppliers only alternative will be the courts and huge legal fees which few will be able to afford.

In this scenario, the subsidiary of the holding company can enjoy the identity of the utility, e.g. LILCO Energy Systems. The subsidiary's overhead would

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continue to be subsidized by the utility and the rate payer. The subsidiary would become the beneficiary of referrals and work generated by the utility.

Utilities in Heating, Cooling and Energy Conservation

The business that I am in is not a simple business. Success requires an intimate knowledge of plumbing, heating and cooling systems. While the utilities have an ability in marketing their products and services, without training, they lack the necessary expertise.

In Rochester, in spite of the fact that the local utility was selling water heaters, they never attained the complete expertise in handling entire systems and the ability to handle plumbing problems that related to the installation of hot water equipment. They depended upon the outside contractor to do this work for them.

The prospects for failure in this field by the utility are very real. As mentioned earlier, in a failure the ratepayer pays the costs while in a success its the investor and not the ratepayer who benefits.

Mr. Chairman, while there may well be changes required in the Public Utility Holding Company Act to eliminate many of the regulatory burdens, I don't feel that it is in the public interest to allow and to encourage further utility diversification. Diversification will have a negative effect on competition by allowing the protected position and benefits of the utility monopoly to be utilized in non-utility fields. We urge that as long as utilities enjoy a protected monopoly status that there functions be limited to producing energy.

If utilities are allowed to diversify into heating, solar, hot water, etc., they will force many marginal wholesalers and contractors out of business.

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STATEMENT OF THE

AMERICAN IRON AND STEEL INSTITUTE

TO THE

SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER

COMMITTEE ON ENERGY AND COMMERCE,

U.S. HOUSE OF REPRESENTATIVES,

REGARDING PROPOSALS TO MODIFY OR REPEAL

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

The American Iron and Steel Institute (AISI) is pleased to submit the following statement of position regarding current efforts to repeal or modify the Public Utility Holding Company Act of 1935 ("PUHCA"). That Act provides a federal regulatory scheme that imposes certain restrictions on the financial and diversification activities of utility holding companies and their affiliates in recognition of the franchised monopoly power that they wield.

AISI is the principal trade association for the steel industry. Its 64 domestic member companies (who are listed in Appendix A) account for approximately 91 percent of the raw steel production capability in the United States. These AISI member companies use, in the manufacture of steel, about three percent of all the energy consumed in the United States. During 1981, AISI member companies and other steel producers purchased 43.6 billion kilowatt hours of electricity. AISI thus has a significant interest in promoting the development of and adoption of coordinated, rational and consistent

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Federal policies which will assure an adequate, reliable and efficient electricity supply for all users at prices based upon the costs incurred in serving those customers.

Because electricity is the most expensive form of energy purchased by AISI members, and because newer steel-making processes are increasingly electricity-intensive, AISI believes that it is imperative that Congress consider the impact of any changes in PUHCA on the utility ratepayer before it repeals or materially modifies PUHCA. Thus far, the debate seems to have focused primarily upon the arguments advanced by the utility company advocates of repeal or modification. While AISI shares the interest of all companies in eliminating unnecessary or duplicative regulatory burdens, it does not believe that that is the key issue here. The key question confronting Congress regarding PUHCA is whether electric utilities can be regulated without PUHCA in a way that will prohibit such utility monopolies from forcing their captive customers - AISI members and all other utility ratepayers - to pay for benefits going to others.

Because AISI does not believe that this question has been adequately analyzed from the perspective of ratepayers, it submits that the Congress should not take any action this Session to repeal PUHCA but instead should (1) continue to study this and related issues, (2) review carefully the NARUC Ad Hoc Committee Report on Utility Diversification, due in late July, and (3) request that the GAO or

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the CRS conduct an analysis of the extent to which portions of PUHCA are duplicative or unnecessary in the light of other federal statutes, existing state laws, and current economic realities confronting electric utilities and steel companies alike.

With these further reports and studies in hand, the Congress - probably in the next Session - would be in a position to take action on PUHCA. The challenge then would be to modify the 1935 Act in a way that still recognizes the basic concerns that led to its passage but meets those concerns with as flexible and light-handed a regulatory framework as possible.

In support of its position opposing repeal of PUHCA at this time, the AISI submits the following:

1. Advocates of repeal emphasize that federal regulation by the SEC is unnecessary since state regulators have sufficient authority and are there to prevent monopoly abuses of power by electric utility holding companies. AISI disagrees with this analysis, on at least four grounds, as follows:

   a. Existing federal and state securities laws, and their regulation, relate to the protection of stockholders, and investors. Here, our focus must be the protection of monopoly ratepayers.

   b. Even if state PSC's have the authority to approve financing by operating utilities within their States, an interstate holding company can probably evade this regulation by raising funds through the holding company.

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At present, SEC reviews all financings by the holding company. A reasonable requirement would be to continue to require that holding companies file their investment plans with the SEC, but that approval of those plans be automatic unless an affected State objects to the company's diversification program. If some states approve and others object, the SEC would decide as the Federal arbiter.

c. Absent a centralized record-keeping activity within the SEC for interstate utility holding companies, AISI does not see how state regulators will be able to achieve effective access to a holding company's books. This is important, because different decisions by different states may have implications for the capital structure to be used for rate-setting purposes, and PSC staffs need to be able to inspect the records of affiliates to insure that transactions between the utility and holding company affiliates do not harm ratepayers.

d. Without some broad, over-all review of the scope of a utility's diversification plans, preferably by the SEC, ratepayers will have no assurance that the regulated utility side of the business remains a significant fraction of the whole so that state PSC actions get the attention of the holding company. As AISI sees it, the "hearts and minds" of utilities will follow state PSC desires only to the extent the utility operation of the holding company remains

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a significant enough part of the holding company's total operations. This is why a periodic overview of the utility's broad strategic diversification plans by either the SEC or FERC is so important. Moreover, AISI is not sanguine that state PSCs have the resources, the expertise, or the ability to take over in an area where they have heretofore relied upon federal government regulation, and where, if PUHCA were repealed, the federal government had pulled out.

2. Some proponents of repeal have suggested that the Congress would be able to fill the regulatory gap using its oversight function. However, AISI believes that since Congress cannot perform the kind of in-depth company-by-company auditing that is essential to assure that the interests of ratepayers are adequately protected, it wisely delegated that power to an expert regulatory body, the SEC. That is where it should remain, albeit in as flexible and light-handed regulatory framework as possible.

3. Whether repeal of PUHCA will enable utilities to improve their overall financial condition is far from clear, but what is clear is that if a diversification venture succeeds, the stockholder will benefit, and <u>if</u> there is no cross-subsidization the rate-payer won't be penalized. If on the other hand the new venture fails, or if there is cross-subsidization, the ratepayer has borne involuntary risks and may pay involuntary penalties.

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Also, it seems to AISI that the "financial plight" cry no longer has the validity it once did. It now applies, regretably, to the steel industry.

4. While PUHCA does require utilities subject to it to do significant planning, it has not prevented them from making acquisitions that are consistent with their purpose as utilities.*/ The nine electric utility holding companies own sixty utilities which represent 20% of the U.S. industry with assets of nearly $50 billion and revenues of $17 billion. Thus while the price of PUHCA regulation may be regarded by some of those subject to it as too high, from the perspective of ratepayers it does not seem out of proportion to the benefits granted by the franchise each utility enjoys.

5. To suggest that no one will be hurt by repeal is disengenuous. It is possible that AISI members' electric bills could increase in any number of ways : failure of the diversified venture, inappropriate transfer pricing, improper allocation of common utility and non-utility costs, and possible spin-off of a utility system, or take-over of a utility or its holding company by a U.S. or non-U.S. firm.

Conclusion

For the foregoing reasons, AISI opposes repeal of PUHCA at this time. AISI believes that its position is not inconsistent with the thrust of the revised Administration position to stay the effective date of any repeal legislation for two years to give states time to consider additional legislation.

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*/ Even this kind of diversification, however, is of concern to the Justice Department, but nonetheless Mr. Baxter concluded that PUHCA should be repealed. (Testimony, June 8, 1982).

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APPENDIX A

American Iron and Steel Institute

Domestic U.S. Company Members

Allegheny Ludlum Steel Corporation
AL Tech Specialty Steel Corporation
American Cast Iron Pipe Company
Armco Inc.
Atlantic Steel Company
The Babcock & Wilcox Company
Bekaert Steel Wire Corporation
Bethlehem Steel Corporation
Bristol Metals, Inc.
Carpenter Technology Corporation
CF&I Steel Corporation
Charter Manufacturing Company, Inc.,
Charter Rolling Division
The Cleveland-Cliffs Iron Company

Columbia Tool Steel Co.
Consolidated Metals Corp.
Continental Copper & Steel Industries, Inc.
Copperweld Corporation
Cyclops Corporation
Electralloy Corporation
A. Finkl & Sons Co.
Florida Steel Corporation

Green River Steel Corporation
Guterl Special Steel Corp.
The Hanna Mining Compnay
Harsco Corporation
Ingersoll Johnson Steel Company
Inland Steel Company
Intercontinental Metals Corporation
Interlake, Inc.
Jessop Steel Company
Jones & Laughlin Steel Corporation
Earle M. Jorgensen Company
Joslyn Stainless Steels, Division of
Slater Steel Inc.
Kaiser Steel Corporation
Keystone Consolidated Industries, Inc.
Korf Industries, Inc.
Laclede Steel Company
Lone Star Steel Company
Lukens, Inc.
McLouth Steel Corporation
National Steel Corporation
North Star Steel Company
Northwestern Steel and Wire Company
Oglebay Norton Company
Oregon Steel Mills, Division of
Gilmore Steel Corporation
Phoenix Steel Corporation
Pickands Mather & Co.
Raritan River Steel Company
Republic Steel Corporation
Roblin Industries, Inc.
Rome Strip Steel Company, Inc.
Sandvik, Inc.
Sharon Steel Corporation
Sharon Tube Company
Shenango Incorporated
Teledyne Columbia-Summerill, Division of
Teledyne Industries, Inc.
Teledyne Vasco, Division of
Teledyne Industries, Inc.
The Timken Company
Union Electric Steel Corporation
United States Steel Corporation
Valley Mould & Iron Company
Washington Steel Corporation
Wheatland Tube Company
Wheeling-Pittsburgh Steel Corporation

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STATEMENT OF THE
ELECTRICITY CONSUMERS RESOURCE COUNCIL
TO THE
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER,
COMMITTEE ON ENERGY AND COMMERCE,
U.S. HOUSE OF REPRESENTATIVES,
REGARDING PROPOSALS TO MODIFY OR REPEAL THE
PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

The Electricity Consumers Resource Council (ELCON) is pleased to submit the following statement to the Subcommittee on Energy Conservation and Power of the House Committee on Energy and Commerce. The purpose of this statement is to present ELCON's views on current efforts to modify or repeal the Public Utility Holding Company Act of 1935. This Act places certain restrictions on the financial and diversification activities of utility holding companies and their affiliates, and as such has an important impact on utilities and their customers.

ELCON is a group of seventeen large industrial consumers of electricity with facilities in most of the fifty states.[1/] ELCON advocates and promotes the development and adoption of coordinated, rational and consistent federal, state and local policies which will assure an adequate, reliable and efficient electricity supply for all users at prices based on the costs incurred in serving customers.

ELCON's members consume approximately ten percent of all electricity sold to industrial customers and nearly five percent of all electricity sold in the U.S. Because of our members' use of electricity, ELCON has a significant, continuing interest in the electric utility industry, and we appreciate the opportunity to comment on this important regulatory issue.

1/ ELCON members are: Air Products and Chemicals, Inc.; Airco, Inc.; Anheuser-Busch Companies, Inc.; Armco; Bethlehem Steel Corporation; Diamond Shamrock Corporation; E.I. du Pont de Nemours & Company; FMC Corporation; General Motors Corporation; Kaiser Aluminum & Chemical Corporation; LCP Chemicals & Plastics, Inc.; Nabisco Brands U.S.A.; Olin Corporation; PPG Industries, Inc.; Stauffer Chemical Company; Union Carbide Corporation; and United States Steel Corporation.

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ELCON's members support the efforts of the Reagan Administration's regulatory relief task force, chaired by Vice President Bush, to identify federal laws and regulations that impose excessive burdens on business, individuals, and state and local governments, and to identify ways to alleviate these burdens. In appropriate cases, ELCON has supported the repeal or modification of federal laws or regulatory programs affecting electricity.

Summary:

Although we support regulatory reform efforts where appropriate, ELCON opposes efforts to repeal the Public Utility Holding Company Act of 1935 (PUHCA or Act). ELCON believes that those who support such action should consider the possible effect that repeal of the PUHCA might have on the Nation's electric utility customers.1/ Evidence that substantial portions of the Act are duplicative of other federal or state authority, that the problems which brought about its enactment will not reappear upon repeal, and that the protection provided by the Act is either no longer necessary or is adequately provided for by other statutes needs to be considered. ELCON stands ready to support modification or repeal of those portions of the Act that are shown to be duplicative or unnecessary.

Discussion:

ELCON's analysis of the PUHCA indicates that some of its major provisions remain relevant to today's economic circumstances. The fact that a major restructuring of the utility industry has been accomplished under authority of the Act is not convincing that past practices may not reappear absent oversight. It also seems apparent that other regulatory authorities (e.g.,

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1/ ELCON recognizes that the provisions of the PUHCA apply to both gas and electric utility holding company systems. However, our interest in the current proceeding applies only to the electric utility industry. Therefore, our comments on the proposed legislation are limited in applicability to the electric utility industry.

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the Federal Energy Regulatory Commission and state public utility commissions), whose major purpose is to deal with ratemaking matters, simply do not have the necessary authority and/or expertise to effectively scrutinize the other financial aspects of interstate utility operations.

During testimony before both Senate and House Subcommittees, it was asserted by those advocating repeal or substantial amendment to the PUHCA that the financial health of utilities was closely related to diversification and, in turn, diversification depended on repeal of the PUHCA. We do not agree with those presentations. The financial health of the industry does not hang on the issue of diversification, and diversification does not depend upon repeal of the PUHCA.

ELCON's concern with repeal is based on the fact that the consequences of repeal cannot be documented. True, in forty-seven years since the passage of the Act the industry has not demonstrated any serious recurrence of the problems associated with the industry in the 1920's and 1930's. One can argue, as some do, that therefore the Act is no longer necessary. More objectively, it can be argued that the Act has been in effect for forty-seven years and that is why the previous abuses have not reoccurred.

Whether the "pyramiding" to which the Act was largely addressed will reappear after repeal is to a large extent conjecture. It would not be logical to assume the utility industry seeks repeal in order to return to the days of highly leveraged, holding company "pyramids." Uncertainty, high interest rates and precarious financial circumstances are not the stuff of which pyramids are built. We do not, therefore, question the utility industry's motives in this regard. We do question what regulatory oversight would remain, after repeal, to deal with interstate utility holding company financial issues.

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We would much prefer a streamlined federal statute stripped of regulatory redundancies that maintains adequate oversight of the industry's structure. Absent the PUHCA, responsibility for overseeing the development of the industry structure will fall largely on state bodies. There is little consistency among the states, and even worse, lack of jurisdiction in interstate matters.

Thus, the question reduces to the gains and losses for all parties from a repeal of the PUHCA.

It does seem clear that registered holding companies are subject to regulation of their securities activities to an extent that impairs their ability to offer the lowest cost product to their customers. In addition, the ability to diversify is somewhat impaired by the PUHCA. Though we reject the notions that diversification is not possible under PUHCA and that diversification will have a substantial effect on utility financial health, nevertheless, we see no reason for the additional restrictions on financing opportunities for utilities operating under the holding company device. Repeal or modification could offer increased diversification opportunities to registered and exempt holding companies.

The claim is made that utilities will enjoy improved credit standing in the eyes of investors if permitted broader diversification opportunities. Such improvement, it is claimed, will lower the overall cost of capital to the utility entity. There also remains, however, the possibility that the utility status will attract capital while the risk of diversification will be shifted to consumers from stockholders. This argument is tied to the diversification issue more that to repeal of the PUHCA. We are not convinced that any generalizations are possible a priori about the impact of repeal, other than the hopes expressed about the effect of diversity on the cost of capital. No doubt the effect will

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be substantially different for different utilities. To the extent that generalizations are unconvincing one way or the other ELCON feels no real confidence should be placed on assertions regarding the impact of repeal on utilities' cost of capital.

Perhaps the most telling criticism of the PUHCA is the seemingly contradictory principles involved in regulation of registered vs. exempt holding companies. The pervasive security regulation under PUHCA of registered companies does not apply to exempt holding companies. The fact that registered companies operate over state lines while exempt companies are confined largely to intrastate operations does not seem at present to be a compelling reason for such extraordinary regulation of registered company security activity. Both types of companies are subject to the 1933 and 1934 Securities Acts, so additional restrictions on registered holding company financial activity does not seem warranted.

The argument as to the possible conflict of interstate and intrastate regulation leaves ELCON with residual concern regarding the ability of state commissions to adequately supervise the relationship between interstate, diversified holding company operations. We do not, however, wish to translate that concern into a larger than life fear of consequences for utility customers or stockholders. We simply do not know how state legislatures and state commissions will respond to the potential gap in oversight. Contrary to assertions made by some, all state PUC's do not currently have the authority to deal with financial transactions within holding company systems. Illustrative of the kind of state legislation that would be encouraged by repeal of the PUHCA is the bill enacted by the New Mexico legislature at the end of its session this past February. That bill imposes a 15-month moratorium on utility

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diversification into non-utility related business, directs further legislative study of diversification, and mandates the state PSC to come up with a rulemaking on the same issue by November 30, 1984. The Wisconsin PSC is in the process of promulgating regulations regarding utility diversification, and the Maine legislature passed and the Governor signed a bill that gives the Maine PUC jurisdiction over the setting up of utility holding companies in that state. Similarly, state legislatures would doubtlessly feel motivated to re-examine their statutes (if any) applicable to transactions between public utilities and their affiliates. Today, some are explicit, some are general, and in some cases there is no relevant statutory provision.

Finally, it is claimed that exempt holding companies view the possibility of revocation of their exemption under the Act as a continuous and possibly arbitrary threat. We certainly agree that regulation should not be capricious or arbitrary. Repeal would, of course, remove the somewhat artificial difference between registered and exempt holding companies but, as we have stated earlier, this gain in symmetry is offset by the uncertainty in oversight, since the states may act in a manner that creates rather than cures uncertainty.

If the Act is repealed we think the recommendation of Dr. Richard E. Schuler, Deputy Chairman of the New York PSC, testifying on behalf of NARUC, has merit. He suggested that in the event of passage of a repeal bill or modification to the PUHCA, the effective date of the legislation should be no sooner than 12 months after passage. This would allow time for states to consider and implement their response to the federal action.

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Conclusion:

Although ELCON opposes repeal of the PUHCA, it is sympathetic to utility concerns regarding unnecessarily expensive and burdensome regulation. Accordingly, to the extent that any reporting requirements and layers of regulatory review and oversight imposed by the PUHCA are duplicative of other federal or state regulatory requirements or are unnecessarily burdensome, ELCON agrees that a strong case is made for modification of the Act. Indeed, the recodification and simplification of the PUHCA prepared by the American Law Institute in 1975 should be considered by the Congress as one alternative in its review of what provisions of the Act should be retained in the 1980's and beyond.

The Congress might also consider a transfer of the SEC's responsibility under the PUHCA to the FERC. The rationale for this transfer of authority would be that if administration of the PUHCA was assigned to the FERC, better integration of all regulatory responsibilities relating to public utility holding companies could be achieved by one federal agency.

ELCON has attached to this statement its analysis of the PUHCA.

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THE PUBLIC UTILITY HOLDING COMPANY ACT AND ELECTRIC UTILITY DIVERSIFICATION

EXECUTIVE SUMMARY

Efforts are currently underway which call for substantial modification or repeal of the Public Utility Holding Company Act of 1935 (PUHCA or Act). Several bills have been introduced in Congress, and the electric utility industry has initiated a campaign seeking modification or repeal of the Act and is developing a strategy for increased efforts in electric utility diversification into nonutility-related activities.

The utility holding company act was enacted in 1935 to correct abuses of the holding company device and to promote effective state regulation. At that time, 13 large holding companies controlled approximately three-fourths of the privately-owned electric and gas utilities in the United States. Abuses which the Act was designed to correct include inadequate disclosure of financial information, unsound financial and corporate practices, excess charges to utilities for services provided by subsidiaries, extension of holding company systems without regard to economics of operation or integration of facilities, and obstruction of effective state regulation.

The provisions of the Act empower the Securities and Exchange Commission (SEC or Commission) to confine a utility holding company to a single integrated system, simplify financial structures of registered holding companies, prevent unsound business practices, require all services provided by affiliated companies to be provided at cost properly allocated, require SEC approval of acquisition of other utilities, prohibit the use of funds derived from utility securities to finance nonutility ventures, restrict intercompany loans, dividends, security transactions, sale of utility assets, solicitation of voting proxies, and political contributions. Section 3 of the Act also provides for SEC exemption of utility holding companies

from most of the provisions of the Act, based primarily upon geographic integration of the company, and subject to SEC revocation.

Restructuring of the utility industry and simplification of its financial structure have substantially been completed under authority of the Act. Several major investigations of the PUHCA and its administration by the SEC have found that its authority under the Act is largely nonduplicative of other federal or state statutes. There is, however, some question as to the continued need for SEC restrictions on registered holding company security issues.

State regulatory commission authority to control financial and diversification activities of jurisdictional utilities is limited and diverse. State commissions are primarily concerned with ratemaking issues and have limited authority over utility investment in nonutility activities, particularly when these are located in another state.

Considerable diversification by electric utilities has taken place, largely in areas related to utility operations, even with the PUHCA in force. Most utility holding companies have received exemption from most provisions of the Act, under Section 3 authority. There is some concern that the SEC has applied its exemption powers too broadly, resulting in uneven regulation of the industry.

The main benefit to be derived from expanded electric utility diversification is alleged to be the improved financial position of the industry. The available evidence, however, indicates that utility diversification into nonutility activities may contribute to the long-term problems of the industry rather than improve them. Inadequate returns to utility investment should be dealt with directly through the granting of rate relief rather than indirectly through diversification activities.

Substantial utility diversification into nonutility activities poses potential problems for state regulators in such areas as protection of the utility and its customers from unsuccessful nonutility activities, separation of utility and nonutility costs and revenues, determination of the utility's cost of capital, and possible misuse of utility funds and assets. Regulators need to prevent potential financial and operating abuses rather than deal with them after they happen. To this end, continued surveillance of the industry, as provided for in the PUHCA, may be required to protect the public interest.

In light of the available information, ELCON should oppose repeal of the PUHCA, unless explicit evidence is presented to show that the authority of the Act is substantially duplicated by other federal or state authority. However, modification of the Act, particularly those parts that place restrictions on registered holding company financings, may be in order. Electric utility diversification into related areas of operation has taken place and should not be discouraged. We are convinced that substantial diversification into unrelated activities is problematical as a substitute for effective state regulation.

I. INTRODUCTION

There has been much interest recently in the Public Utility Holding Company Act of 1935 and its effect on electric utility company diversification activities. There are currently several bills pending before Congress to modify or repeal the Act.[1/] The electric utility industry has mounted a campaign calling for modification or repeal of the Act and is developing a strategy for increased electric utility involvement in diversification activities.

As consumers of large amounts of electrical energy, industrial customers have a major interest in the possible effects of a significant change in federal regulation of the electric utility industry. ELCON and its members need to be aware of the possible effects of modification or repeal of the PUHCA on the availability of electric energy.

There are many questions pending about the continued need for the Act, on the reasons for its enactment, duplication of other state and federal authority, its effect on electric utility diversification activities, and the ability of state regulators to effectively regulate diversified, multijurisdictional utilities in the absence of the Act's authority. The purpose of this report is to provide background information and analysis of these and other issues as they relate to the PUHCA and electric utility diversification, and to determine if there is a need for an ELCON position regarding possible modification or repeal of the Act.

1/Senators Alfonse D'Amato and J. Bennett Johnston have introduced Senate bills S. 1869, S. 1870, and S. 1871, all of which are intended to modify certain provisions of the PUHCA. Representative Tom Corcoran has introduced bill H.R. 5220 which is similar in nature to the various Senate bills, and Senator Johnston and Representative Tauzin have introduced bills S. 1977 and H.R. 5465, respectively, which would repeal the Act in its entirety.

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II. THE ISSUE

The issue to be considered by ELCON is: Should the PUHCA be modified or repealed to allow further diversification of electric utility companies into activities heretofore prevented or restricted by provisions of the Act? The electric utility industry is interested in intensifying its diversification activities into areas both related and unrelated to electric power production, and cites provisions of the Act which prevent or inhibit it from doing so. The reasons for the industry's increased interest in this area include: alleged increase in risks associated with electric utility operations; inadequate returns to operations due to inadequate rate relief and regulatory neglect; and little likelihood of sustained growth in industry sales or revenues for the foreseeable future.2/

As a result, the industry is seeking to expand its activities into other areas of operation as a means to increase the potential for future sales and revenue growth. It is felt that funds invested in nonutility operations have a greater potential for achieving adequate returns since these investments are not subject to the direct control of regulatory commissions.3/ Diversification may also provide a rate of growth in earnings not available to electric utility operations.

It is hoped that increased diversification will lead to geographic and customer diversity and will improve the financial community's evaluation of industry earnings. This, in turn, will improve utility company price/earning ratios,

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2/"Business Diversification: A Strategic Option for U.S. Investor-Owned Utilities," by Terry Ferrar, Management Review, November 1981, pp. 13-23.

3/The Electric Utility Industry: The Future is Taking Shape, by E. J. Tirello, Jr. and S. Fedun, Lehman Brothers Kuhn Loeb Research, New York, November 1981.

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decrease the industry's cost of capital, and improve its market-to-book ratio and its bond coverage ratio. However, utilities must be assured that profits resulting from investments in nonutility activities are not subject to state or federal regulatory commission control; hence, the industry's interest in modifying or repealing the PUHCA.

State regulators point out the unique characteristics of the electric (and other) utility industry that led to its regulation in the first place.[4/] They point to the fact that utilities furnish services generally considered to be essential to the public and of critical importance to the nation's economic infrastructure. They also mention that these services are provided through investments that are much more capital intensive than most other industries and that utilities are obligated to provide service to all customers and must attract large amounts of capital to ensure adequacy of supply. Also, utilities operate as franchised monopolies, that is, this critical service is provided by only one company in a particular service territory and utilities require the use of streets and highways and the power of eminent domain to carry on their activities.

As a result of these unique characteristics, utilities are subject to state and federal regulation -- including the PUHCA -- designed to protect the public while providing adequate financial returns to the industry. Moreover, regulators must assure that the industry does not circumvent effective regulation nor jeopardize its ability to provide adequate service at reasonable prices by engaging in activities beyond the purview of state and federal regulatory agencies. As a 1972 report on nonutility investments pointed out:

4/1972 Report of the Ad Hoc Committee on Non-Utility Investments, National Association of Regulatory Utility Commissioners, Eighty-Fourth Annual Convention, Washington, D.C., November 1972.

The maintenance of assured public utility financing is of such critical importance that every effort should be made to sever public utility operations from non-public utility operations, particularly where the latter are substantial in scope... The threats posed by extensive utility diversification are neither new nor illusory. Indiscriminate diversification by public utilities was one of the factors underlying passage of the Public Utility Holding Company Act of 1935... The current emphasis in regulatory circles is on taking preventive measures, rather than waiting for a crisis before taking action. Regulatory officials would be justly subject to criticism if ... appropriate measures were not taken to protect the critical function of public utility financing from possible impairment resulting from uncontrolled diversification. 5/

5/ Ibid., p. 721.

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III. THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Conditions That Led to Enactment

According to the Securities and Exchange Commission, the PUHCA was adopted in response to the control exercised by a relatively few large financial corporations of a major part of the gas and electric utility industry.[6/] In 1932, thirteen large holding companies controlled three-fourths of the privately-owned electric and gas utility companies, with about 45 percent of ownership concentrated within the three largest holding companies. The SEC notes that this situation was aggravated by the unsoundness of utility holding company financial structures and the lack of meaningful economic or operational relationships among the constituent parts of holding company systems. It also notes that the Congress was particularly concerned that the effectiveness of state regulation of utility systems was seriously impaired by such use of the holding company device.

Section 1 of the PUHCA mentions a number of abuses which the Act was intended to correct. These are:

(1) Inadequate disclosure to investors of the information necessary to appraise the financial position and earning power of public utility holding companies.

(2) The issuance of securities against fictitious and unsound values.

(3) The overloading of operating companies with debt and fixed charges.

(4) The imposition of excess charges upon operating companies for various holding company supplied services.

6/ Comments of the Securities and Exchange Commission on the Comptroller General's Report of June 20, 1977, to the Congress on the Administration of the Public Utility Holding Company Act of 1935, Securities and Exchange Commission, Washington, D.C., 1977, p. 1.

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(5) The control by holding companies of the accounting practices and rate, dividend, and other policies of their operating subsidiaries so as to complicate or obstruct state regulation.

(6) The control of subsidiary holding companies and operating companies through disproportionately small investment.

(7) The extension of holding company systems without relation to economy of operations or the integration and coordination of related properties.

Major Provisions of the PUHCA

The Act deals with these problems through the authority provided in its various sections. In general, the Act provides for the simplification of utility holding company financial structures and attempts to prevent future abuses of the holding company device by restricting certain actions of companies subject to the Act. It is worth emphasizing that the intent of the PUHCA is to promote effective state regulation of electric and gas utility companies. It is not intended to replace state regulatory authority with federal jurisdiction.

The major authority of the SEC to limit or control the actions of utility holding companies is contained in Sections 9 through 13 of the Act. Section 9 prohibits registered holding companies from acquiring securities or assets of other utilities or any other business unless the acquisition has been approved by a state commission, or the SEC determines that such acquisition is not detrimental to the public interest or the interest of investors or consumers. Section 10 establishes the terms for SEC approval of such acquisitions. It requires that the registered holding company file an application for approval with the SEC. The Commission must then determine that the acquisition is not detrimental to the public interest

nor the interest of investors or consumers, and that the acquisition will serve the public interest by tending towards the economical and efficient development of an integrated public utility system. These provisions do not apply to the acquisition of securities or assets of a public utility operating exclusively outside of the United States.

Section 11 of the PUHCA provides for the simplification of utility holding company systems. It authorizes the SEC to examine the corporate structure of all registered holding companies and their subsidiaries and requires that such companies limit their operations to a single integrated public utility system and to such other businesses that are reasonably incidental or economically necessary or appropriate to the operations of such an integrated system. Exceptions are permitted where the SEC determines that such additional systems cannot be operated as an independent system without the loss of substantial economies, all such additional systems are located in one state or in adjoining states or in a contiguous foreign country, and the continued combination of such systems under the control of a holding company is not so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

Section 12 places limits and restrictions on registered holding companies with regard to intercompany loans, dividend payments, security transactions, sale of utility assets, solicitation of proxies, and political contributions. Section 13 of the Act provides that any subsidiary company or mutual service company of a registered holding company that performs any service, sales, or construction contract for any associate company within the system do so in an economical and efficient manner at cost fairly and equitably allocated among such companies.

In addition to these enforcement powers, the Act provides for the exemption of utility holding companies and their subsidiaries and affiliates from the

provisions of the Act. Section 3 provides for the SEC to grant such exemption for those companies that are:

(1) Predominantly intrastate in character and carry on their business substantially in a single state in which such holding company and every such subsidiary company thereof are organized.

(2) Such holding company is predominantly a public utility company whose operations do not extend beyond the state in which it is organized and states contiguous thereto.

(3) Such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public utility.

(4) Such holding company is temporarily a holding company solely by reason of the acquisition of securities for purposes of liquidation or distribution.

(5) Such holding company is not a public utility and derives no material part of its income, directly or indirectly, from one or more subsidiary companies which are predominantly public utility companies principally operating within the United States.

A company does not need to meet all of these requirements to qualify for an exemption. According to Section 3, qualifying companies are exempt from the Act (except for the provisions of Section 9 requiring both exempt and regulated companies to obtain SEC approval before acquiring additional security interest in public utilities) unless the SEC determines that such exemption is detrimental to the public interest or the interest of investors or consumers. Also, the SEC may revoke such an exemption if it finds that the circumstances that gave rise to the exemption no longer exist.

It is this possibility of revocation of exempt status that the electric utility industry objects to. Industry spokesmen point out that this possibility limits diversification into nonutility activities for fear that the SEC may cause a previously exempt utility to become subject to the full authority of the Act. Also, utilities may be reluctant to form holding companies for the purpose of pursuing nonutility diversification because they would be required to register with, and be subject to regulation by, the SEC or would need to qualify for an exemption under Section 3 of the Act.

Is the PUHCA Still Needed?

In calling for the modification or repeal of the PUHCA, some parties have asserted that the major purpose of the Act, the restructuring of public utility holding companies, has already been accomplished, that the Act is duplicative of other federal and state authority, that most utility holding companies have received exemption from most of the provisions of the Act, and that the Act is unduly restrictive of utility company diversification activities. The last of these assertions will be taken up in the following section of this report. The other assertions deal with the general problem of the continued need for the Act; that is, do the conditions that gave rise to the Act still exist or have events caused its continued enforcement to be unnecessary?

A precise answer to this question would require a detailed review of all applicable federal and state statutes pertaining to regulated public utilities. This type of review is beyond the purposes of this report. There is, however, general agreement as to the lack of uniformity in utility regulation at the state level. A few general observations and conclusions regarding this issue, based upon available information, are presented below.

There is little, if any, doubt that under the authority of the Act, the SEC has effected the restructuring of the utility industry into one composed of single-integrated systems and geographically-integrated holding companies. The SEC has also accomplished the simplification of utility holding company financial structures by eliminating unnecessary layers of ownership and control.

This restructuring has been accomplished by SEC authority, provided by the Act, to cause divestiture of assets unrelated to public utility operations, to approve mergers and acquisitions, and to simplify unnecessarily complicated financial structures. This type of oversight of holding company activities. which is intended to control the size and geographic diversification of utility operations in order to promote effective state regulation of other aspects of the regulatory process such as rates, requires continued SEC supervision of holding company operations. For even though a major restructuring of the industry has been accomplished, if such authority is repealed activities can take place which may erode past accomplishments.

In regard to its authority to affect the size and structure of utility holding companies as provided by the PUHCA, the SEC has stated that:

> The standards affecting the size and structure of electric or gas utility companies, such as the definitions of an integrated system in Section 2(a)(29), are couched in qualitative economic terms and expressly refer to relevant current conditions. Accordingly, such standards are not subject to obsolescence.7/

With regard to the duplication of other federal and state authority, it is worth noting that Congress passed the PUHCA in 1935 after the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. This ordering

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7/Securities and Exchange Commission, op cit, pp. 33-34.

of events implies that the Congress felt that the previous acts did not effectively deal with the problems associated with public utility holding companies. Also, the 1933 and 1934 acts are primarily aimed at investor protection, while the PUHCA places primary emphasis on consumer protection and the promotion of effective state regulation of natural monopolies. The unique position of utilities — that of being monopolies that provide essential services to the public — is also worth noting. This presents a problem dealt with in the PUHCA that is not encountered in securities regulation of other types of industries: the separation of utility and nonutility activities, revenues, and costs. However, where duplication of authority can be shown to exist or where restrictions on holding company financial transactions can be shown to be overly burdensome and costly, a strong case for modification of the relevant sections of the Act can be made.

As far as state authority over the activities of utility companies is concerned, state regulatory jurisdiction over utility financing and diversification activities varies widely. While all state commissions have the authority to rule on the appropriateness of costs incurred by jurisdictional utilities in providing service, most have limited authority over associated nonutility operations within that state and all lack jurisdiction over activities of utility subsidiary companies operating outside of the state.

In regard to the duplication of authority question, the SEC has stated:

> There is no serious question that the Commission's authority over registered holding company systems subject to the Act is, to a large degree nonduplicative of the authority of state or other federal regulatory bodies.[8/]

It should be pointed out that the Commission has recently altered its position on the necessity for continued federal regulation of utility holding companies. SEC Chairman, John S.R. Shad, stated in a December 1981 letter to

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[8/] Ibid., p. 24

Senate Subcommittee on Securities Chairman, Alfonse M. D'Amato, that the Commission believes that its task of reorganizing the nation's gas and electric holding company systems under authority of the PUHCA was completed twenty years ago. He also notes that the SEC's administration of the Act in more recent years has primarily involved review of registered holding company financings, merges, and acquisitions and the consideration of requests for exemption. These activities are intended to prevent recurrence of the abuses which led to passage of the Act. However, he states the Commission believes that these abuses are unlikely to recur in light of the extensive changes that have taken place in the public utility and investment banking industries, the accounting profession, state utility regulation, expansion of the disclosure requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934, and the development of more efficient and well-informed securities market. For these reasons, Chairman Shad recommends that the Congress reexamine the underlying premises of the Act to determine the extent to which they have continuing viability today, and should consider repeal of the Act in its entirety.

The NARUC report on nonutility investments also deals with the duplication of regulatory authority issue. The report mentions that at the state level, control over utility financing and diversification activities are for the most part inadequate and vary greatly from state to state.9/ The report states that even though most state commissions have authority to control the disposition of proceeds from the issuance of public utility securities, few have explicit authority to regulate the reinvested earnings of public utilities from their utility operations and even fewer have such explicit authority over nonutility operations. In the case of mergers and affiliations, the NARUC study reports that the pattern of

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9/National Association of Regulatory Utility Commissioners, op cit, pp. 733-734.

state control is similarly incomplete. It is reported that many state commissions have authority to control mergers or affiliations involving utility and nonutility enterprises; however, once the merger or affiliation is completed, further oversight by the state commission is problematical. In this instance, the state commission faces the problem of lack of control over the earnings of unregulated activities which may be employed for further diversification. This in itself is not necessarily a problem, but may contribute to regulatory difficulties as outlined below.

The General Accounting Office (GAO) has also investigated the authority of the PUHCA and the SEC's administration of the Act.[10] In its report to Congress, the GAO states that while there is some overlap of authority between the Act and other federal or state authority, the SEC in large part provdes a nonduplicative type of regulation.[11] The Act empowers the SEC to monitor the operations of utility holding companies and requires them to discontinue certain corporate and financial practices and to divest certain properties. According to the GAO report, states seldom have such broad authority on an intrastate basis, and never on an interstate basis. In addition, the authority of state regulatory commissions varies from state to state. In documenting its position on the nonduplicative nature of PUHCA authority, the GAO report points out that:

(1) State authorities concentrate on rate matters and customer service, areas of regulation in which the SEC does not operate.

(2) Many state authorities lack jurisdiction over unrelated businesses of utility companies within the state, and all lack jurisdiction over such

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10/The Force of the Public Utility Holding Company Act Has Been Greatly Reduced by Changes in the Securities and Exchange Commission's Enforcement Policies, General Accounting Office, Washington, D.C., June 20, 1977.

11/Ibid., p. 7.

out-of-state activities. The SEC exercises authority over nonutility businesses of regulated holding companies.

(3) Most state authorities lack jurisdiction to require corporate reorganization of holding companies and their operating subsidiaries. The SEC, under Section 11 of the Act, has clear authority to do so.

(4) A minority of state commissions are empowered to regulate utility company dividends paid to parent companies. The SEC has such authority under Section 12 of the Act.

(5) The Federal Energy Regulatory Commission (FERC) regulates individual utility companies with regard to wholesale rate matters, and approves financing of some utilities not subject to the Act. It does not have authority to reorganize companies or require divestment of properties.

Utility Companies Exempt from the PUHCA

As reported earlier, Section 3 of the PUHCA provides for exemption of utility holding companies from most of the provisions of the Act. There are currently 12 active holding company systems subject to SEC regulation under the authority of the PUHCA; 10 of these are electric utility holding companies. About 100 other gas and electric utility holding companies have received exemption from SEC regulation. These exemptions, however, are subject to revocation if the SEC finds that the conditions which gave rise to the exemption no longer exist, or the exemption is no longer in the public interest.

SEC administration of the PUHCA has been rather flexibly applied in relation to granting exemptions under Section 3 of the Act. In this regard, the Commission has applied the "functionally related" rule in determining whether to

approve new ventures of holding companies subject to its jurisdiction and in determining the appropriateness of diversification efforts of exempt holding companies.[12] The Commission has also suggested guidelines to be used in judging the appropriateness of diversification activities of exempt holding companies. These guidelines are:

(1) All nonutility activities should be segregated from utility activities through separate corporate subsidiaries.

(2) There should be no services, materials, or contracts between the utility and other subsidiaries except to the extent such contracts were subject to the supervision of state regulatory agencies.

(3) There should be no use of utility operating management, funds, or credit for nonutility purposes.

(4) Nonutility investments should constitute only a relatively small component of the entire system.

(5) Activities should be either complimentary in a significant way to the utility operations or have an established and successful (that is, profitable) record for a reasonable period of time.[13]

There has been some criticism of SEC policy in granting exempt status to utility holding companies, due largely to the fact that the majority of such companies have received exemptions. The GAO noted that the SEC has granted exemptions on the basis of geographic location of holding companies without regard to the size of their operations. It also asserted that the SEC has not developed criteria or standards for deciding how large a holding company needs to be to operate efficiently, be easily regulated, and be responsible to the

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12/ Energy Utility Diversification, Holding Companies, and Regulation, by J. R. Malko, G. B. Enholm, nd T. M. Jaditz, Public Service Commission of Wisconsin, Office of Chief Economist, Madison, WI, September 1981, p. 23.

13/ Ibid., p. 23.

public.[14]/ The GAO also noted that many exempt holding companies are as large as, or larger than, companies not exempted from the Act and that the SEC does not systematically monitor the business activities of exempt companies. This method of enforcement, it concludes, has resulted in a "double standard" being applied to regulated and exempt holding companies, and has resulted in such contradictive results as exempt companies being permitted to operate both gas and electric utility operations, while nonexempt companies are not permitted to do so.[15]/

The SEC has countered this argument by stating that geographic location is the primary standard for granting exemption under Section 3, and that a company does not have to meet all of the standards of the Act in order to be granted an exemption.[16]/

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[14] General Accounting Office, op cit, p. 13.

[15] Ibid., p. 28.

[16] Securities and Exchange Commission, op cit, pp. 19-20.

IV. ELECTRIC UTILITY DIVERSIFICATION

The electric utility industry has increased its interest in diversification activities and in modification or repeal of the PUHCA for a number of reasons. Spokesmen for the industry have noted that electric utilities have suffered the effects of rising fuel costs and general inflation concurrently with inadequate rate relief resulting in reduced and inadequate returns on investment.[17/] Coupled with a reduction in sales growth, the industry sees these developments as a major impetus for expansion of activities into nonutility areas of operation.

Other reasons cited for the increased emphasis on diversification activities include:

(1) A company with diversified product lines and customers can better withstand adverse economic conditions, thereby reducing the impact on overall earnings and profitability.

(2) Diversified activities may offer greater earnings potential and sales growth than traditional lines of endeavor.

(3) Diversification may allow a company to more fully utilize its available resources including company management, operating personnel, production and/or distribution facilities, technical expertise, market contacts, and research activities.

(4) Complementary relationships among affiliated companies, such as cash flow, investment opportunities, tax advantages, and unused tax deductions, can be fully utilized.

17/ Business Diversification - A Strategic Option for the Utility Investor, by Terry A. Terrar, Edison Electric Institute, Washington, D.C., August 18, 1981, p. 1.

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(5) Diversification may improve the company image before investors and the financial community, allowing for easier capital attraction.

(6) Expectation of superior performance following a merger or acquisition may improve stock performance and increase the company's price/earnings and market-to-book ratios.

(7) Diversification may allow the company to better attract and retain qualified management and operating personnel.

(8) Start-up problems for a diversified activity may be minimized by affiliation with an established utility company.

The Edison Electric Institute (EEI) report mentioned that while statistical evidence as to the financial effectiveness of diversification is limited, available data suggest it is worth the careful attention of utility management.[18] The report also states that diversified utilities generally show higher than average price/earnings ratios and market-to-book ratios as compared with non-diversified utilities. It is also mentioned that utilities seeking to diversify must assure that nonutility activities are effectively separated from the utility side of operations so that profits derived from diversified activities cannot be passed through to ratepayers. The report also warns that diversification must not diminish management commitment to providing cost effective, reliable electric service.

A recent survey of investor-owned electric utility companies conducted by the EEI found that a substantial number of utilities have at least one business venture outside of their normal function of supplying electrical energy.[19] The

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18/ Ibid., p. 6.

19/ Investor-Owned Electric Utility New Business Ventures, Edison Electric Institute Economics Division, Washington, D.C., May 1981.

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survey requested information from 161 investor-owned electric utilities regarding utility ownership of business ventures "outside the traditional function of generation, transmission, and distribution of electricity." Of these 161 companies, 125 responded, and of these, 79 companies reported that they had at least one such venture.

These 79 companies owned a total of 247 separate business ventures outside of their utility operations. Of this total, 219 are currently operational, 22 are currently planned, and 6 are inactive. Also, of the 247 ventures identified, 143 (58 percent) are subsidiaries, joint ventures, or affiliates of the parent operating company. The remainder are maintained within the corporate structure of the operating company, e.g., a division within the utility.20/ The survey also reports that of the 143 subsidiary ventures, 66 (46 percent) are regulated in terms of service, rates, or finance by either state or federal authorities, or by both. According to the EEI report, the remaining subsidiaries are not subject to regulatory commission authority.

The 247 business ventures cover a wide range of activities. The most predominant types of business ventures found were fuel exploration and development, real estate, energy conservation services, district heating, cogeneration, appliance sales, leasing and service, fuel transportation and transloading, and load management controls. These eight categories comprised 77 percent of all business ventures identified in the survey. Other types of ventures identified include customer billing and collection services, recreation and marina development, energy education services, aquaculture and horticulture, engineering, architectural, and consulting services, solar and renewable energy product sales,

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20/ Ibid., p. 6.

synfuels projects, computer software sales, word processing, manufacturing of earth mining and heating equipment, and aircraft sales and maintenance. It should be noted that this extensive diversification activity has taken place even with the PUHCA in force.

Financial Aspects of Electric Utility Diversification

The major benefit of electric utility diversification is purported to be the financial gains derived from improved earnings potential and the resultant reduction in the industry's cost of capital. However, diversification may turn out to be a two-edged sword. The acclaimed financial benefits depend on successful diversification activities. Obviously, there is no guarantee that nonutility activities will be successful or provide a greater return than that derived from utility operations. This is particularly true where such activities involve areas of operation unfamiliar to utility management.

Even if successful, there is no guarantee that the benefits derived from diversification activities will flow to the utility. Management may become preoccupied with the higher profit potential of nonutility activities, and use revenues derived from these activities to further diversify rather than apply them to the less profitable utility operations. There is also the potential for using funds derived from utility operations to support nonutility activities, either successful or unsuccessful, to the detriment of the utility. This is precisely the type of activity that the PUHCA was intended to prevent. And, as already noted, state regulatory commissions have limited and varied authority to deal with such matters.

Industry observers have noted that utility experience with diversification activities have varied. Some utilities believe that management can no longer

properly balance the interests of consumers and shareholders without seeking alternative business opportunities. Other utility managements feel that diversification would increase rather than alleviate their problems.[21/] Many of these managers believe that they must instead strengthen inadequate earnings in the electric business through a firm commitment to securing prompt and substantial rate relief.

An analysis of the potential financial benefits of electric utility diversification found that these activities may perpetuate the utilities' poor financial performance, rather than help it.[22/] According to this analysis, the theoretical justification for diversification is to manage the risk associated with earnings, not necessarily to increase the absolute level of expected earnings. The decision to diversify, then, should be seen as an attempt to control fluctuation or variance in earnings, not to achieve a given long-term average earnings level.

The report notes that investors choose from those potential investments that offer the best return for a given level of risk. If one operation within a diversified firm has returns that are too low for its associated level of risk, the return to the enterprise as a whole will be unattractive to investors. That is, the consolidated return to the enterprise after diversification will always be too low for the associated risk. Thus, rather than helping to solve the problem of inadequate returns to utility investment, diversification merely serves to hide the problem. By spreading the deficiency in returns from utility operations over a

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[21/] Lehman Brothers Kuhn Loeb Research, op cit, p. 22.

[22/] "The View from Hagler Bailly," Hagler, Bailly & Company, Inc., New York, No. 1, 1982.

larger amount of equity, diversification increases the average return. As a result, utility stocks initially rise in value, owing to the higher average returns on equity. However, while the average shortfall in earnings is reduced, the total shortfall is not. The diversified set of investments will still have the same shortfall of returns for its given level of risk.

As a result, the direct benefit of utility diversification is illusory. Ultimately, the diversified enterprise will find that the low utility returns will force down the average return to the enterprise, causing it to pay more for debt and equity in all its activities than its competitors at the same level of return (but not the same level of risk). As a result, its competitive position in the market is undermined. The only alternative to the diversified firm, then, is to raise the return on its less profitable utility operations or divest itself of these investments. At the same time, regulators may perceive the short-term rise in value of utility securities as a sign that the return on investment is adequate. Therefore, they may be loath in granting additional rate relief, thus perpetuating inadequate returns to the electric utility industry.

The above discussion confirms our belief that, if utilities are suffering inadequate returns on investment, the best way to deal with this problem is directly through additional rate relief rather than indirectly through diversification activities. The latter, while perhaps achieving short-term improvement in average returns to the industry, is more likely to contribute to its long-term problems.

Recent developments in the electric utility industry point to the validity of the above analysis. Business Week reported that in November 1981, Central Louisiana Energy Company, a diversified energy concern, divested itself of its

electric utility subsidiary, Central Louisiana Electric Company.[23] The reason given for the divestment was the damper on total corporate rate of return resulting from inadequate returns to the utility's operations. The move put the electric utility company back where it was nearly thirty years ago, as a pure power generating utility. The spin-off culminated an eight-year effort by the parent company to assure that profits from its oil, gas, and pipeline operations could not be attached by state regulators eager to keep electric rates low for customers. According to the article, the electric utility was earning about 13 percent on equity, while nonutility operations produced returns around 40 percent.

The NARUC report on utility diversification also dealt with these financial issues and reached essentially the same conclusions. In regard to the supposed reduction in cost of capital due to the greater earnings growth potential of diversified activities, the report concludes that even in the case of successful diversification, the available evidence suggests that diversification increases rather than decreases the cost of capital to the enterprise. This is due to the fact that earnings from nonutility sources are riskier than those of utility operations.[24] It also notes that diversification does not provide guaranteed returns, since success depends upon both the skill of management and good or bad fortune attending various risky ventures. In general, therefore, the utility customer has everything to lose and little to gain through utility diversification. In addition, society is not made better off since those areas into which utilities diversify are no longer available to other corporate enterprises.

The argument regarding diversification of risk is similarly addressed. The report states that it is not clear that successful diversification, even if beneficial

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[23]/Business Week, December 14, 1981, pp. 132-133.

[24]/National Association of Regulatory Utility Commissioners, op cit, p. 721.

to the investor, will be helpful to the utility consumer. The assumption here is that a successfully diversified company earning profits on nonutility operations will invest those profits into an unprofitable utility operation. "Stated this way," the report concludes, "the whole idea is business and financial nonsense, and examples can be found in the history of the railroads and more recently in the activities of Western Union, to support the proposition that businessmen are not anxious to support a losing operation whether or not they are making money on other operations."25/

It should be noted that the NARUC has initiated a second study of utility diversification activities. This report, due to be completed in July 1982, will reexamine many of the issues dealt with in the 1972 study to determine if the conclusions reached in that report remain valid today. These issues include the necessity for continuation of the authority of the PUHCA and the ability of state commissions to effectively regulate diversified utility companies.

25/Ibid., p. 724.

V. UTILITY DIVERSIFICATION AND EFFECTIVE REGULATION

One of the major reasons for enactment of the PUHCA was to promote effective state regulation of utility companies. It has already been mentioned that state regulatory commissions have limited and diverse authority to deal with corporate and financial issues relating to diversified utility companies. However, electric utility diversification presents state regulators with several specific problems.

The study of utility diversification conducted by the Wisconsin commission notes that regulatory interest in utility diversification stems from the requirement of regulators to protect the public interest. The need for regulatory involvement depends upon the form of organization chosen by the utility. An internal utility function is subject to full commission oversight, and a utility subsidiary engaged in utility-related business is very similar to internal utility operations. Once the utility establishes subsidiaries in unrelated business, however, state authorities will not have the same degree of familiarity with the new business venture. A utility holding company established with the intention of pursuing significant diversification can create a situation where the state commission may be unable to effectively deal with nonutility activities without a substantial increase in its authority and staff resources.26/

The report also mentions that if diversified activities are a significant part of total operations, or are expected to become so, the likelihood of cross-subsidization between regulated and nonregulated activities, adverse impacts of business failure, and difficulty of effectively determining the utility's cost of

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26/ Public Service Commission of Wisconsin, op cit, p. 38.

capital increases substantially. The report notes that in some jurisdictions, state commissions have legal authority to regulate transactions by a utility with an "affiliated interest." However, without such authority, state commissions must rely upon conditions established upon SEC approval of formation of the utility holding company (e.g., utility agreement to provide the state commission with all relevant financial information) to effectively regulate the diversified utility.[27]/

The report concludes that a holding company structure provides the utility management with substantial freedom of action but presents the state commission with considerable uncertainty. A holding company can operate subsidiaries in almost any business (absent PUHCA authority) and the utility can become a captive customer in order to increase the likelihood of success of the venture. Separation of existing companies is more readily accomplished with a holding company structure, as is external financing, and a continued internal flow of dividends is maintained. Also, regulatory oversight of nonutility activities is minimized or avoided. However, regulators must be concerned with the possibility of holding company activities endangering the utility's financial position, of being improperly charged for goods and services provided by other subsidiaries, or being required to share the losses on diversified ventures. Regulators also must consider the consequences of energy utility diversification and develop a regulatory strategic plan to deal with this issue.[28]/

The NARUC report reached similar conclusions. While it found that for economic and social reasons the operation of utilities in related fields of endeavor

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27/ Page 41.

28/ Page 42.

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is not only desirable but probably unavoidable, diversification into unrelated activities poses several problems for state regulators. These include cost allocation problems and difficulty in computing the utility's cost of capital.29/

The report notes that a more subtle problem, but one with more serious implications, involves the relationship between the regulated company and the regulatory commission. Absent diversification, the relation is one of mutual dependency. The company needs the support of the commission to obtain revenue required to provide adequate service; and the commission recognizes that unless such revenues are forthcoming service is likely to be impaired.

This situation changes drastically when the regulated company achieves significant diversification. The company is no longer dependent solely on the commission for its revenue and may choose to render less than adequate service if returns to utility operations are perceived as too low. On the other side, the commission may be moved to irresponsible decisions on the premise that if the company fails to derive adequate revenues from the regulated service, it can always rely on its unregulated activities for funds. In either case, a cross-subsidization between regulated and nonregulated activities takes place.

29/ National Association of Regulatory Utility Commissioners, op cit, p. 732.

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VI. SUMMARY AND CONCLUSIONS

The previous discussion points out several important matters to be considered in establishing an ELCON position with respect to modification or repeal of the PUHCA. These include:

(1) The PUHCA was imposed to correct various abuses of the utility holding company device, prevent their recurrence, and promote effective state regulation of utilities. These abuses include inadequate disclosure of financial information, unsound financial practices, excess charges for services provided by subsidiary companies, and extension of utility holding company systems without regard to economies of operation or integration of facilities.

(2) The PUHCA provides for SEC regulatory efforts to simplify financial structures of utility holding companies, prevent unsound business practices, provide adequate disclosure of financial information, eliminate excessive charges for subsidiary-provided services, confine holding companies to a single, integrated utility system, limit the use of utility derived funds for nonutility investments, and restrict intercompany loans, dividends, security transactions, and other financial transactions.

(3) Section 3 of the Act provides for exemption of holding companies from most provisions of the Act based, primarily, on the geographical integration of operations. Currently, the majority of utility holding companies have received exemptions subject to SEC revocation if it is determined that the exemption no longer serves the public interest.

(4) Restructuring of the industry and simplification of its financial structure have substantially been accomplished under authority of the

Act. However, preservation of past accomplishments and prevention of possible future abuses may require surveillance of utility holding company operations.

(5) Authority granted the SEC under provisions of the Act appears to be primarily nonduplicative of other federal and state authority. State regulatory authority over utility diversification activities is limited and diverse. Where such authority can be shown to be duplicative or unduly restrictive of utility holding company financial transactions, a strong case for modification of the Act can be made.

(6) Considerable diversification by electric utilities has taken place, mainly in areas related to utility operations.

(7) Alleged financial benefits to utilities derived from nonutility diversification is unsubstantiated, and evidence indicates that such activities may contribute to the long-term problems of the industry.

(8) If the primary reason for nonutility diversification is inadequate returns to utility operations, as the industry alleges, this problem should be dealt with directly through the granting of additional rate relief rather than indirectly through nonutility diversification.

(9) Extensive nonutility diversification causes difficulties for state regulators in protecting utilities from unsuccessful nonutility activities, separation of costs and revenues, determination of the utility's cost of capital, and possible misuse of utility funds and assets.

(10) Regulators need to prevent holding company financial and operating abuses rather than deal with such occurrences after they take place. Proper administration of the PUHCA provides for continued monitoring of utility holding company activities required to prevent such abuses.

The major reports dealing with the purposes of the Act and the need for its continued enforcement reach substantially the same conclusions. The GAO report recommends that the SEC authorize a study of developments in the gas and electric utility industries to evaluate the individual standards of the Act to determine their continued usefulness.30/ The report also states that the purpose of the Act is not to seek out and punish offenders but to prevent the occurrence of abuse. From this point of view, the absence of demonstrated past harm is not decisive so long as the potential for abuse exists.31/

The NARUC report recommends that state regulatory agencies seek adequate authority to control utility diversification if they do not already have such power. This authority should include control over disposition of proceeds of securities issues of public utilities, control over investment of utility funds in nonutility enterprises, control over merger or affiliation of public utilities with nonutility enterprises, and power to order severance of nonutility from utility operations when it is in the public interest to do so.32/ The report also recommends that utility companies should continue to be subject to the PUHCA where they are components of public utility holding company systems. Also, the exemptions of presently exempt holding companies should be reexamined and, if necessary to prevent improper diversification, should be revoked.33/

30/ General Accounting Office, op cit, p. 17.

31/ Ibid., p. 31

32/ National Association of Regulatory Utility Commissioners, op cit, p. 734.

33/ Ibid., p. 735.

ELCON's Position

In light of the available evidence, it seems proper that ELCON oppose repeal of the PUHCA, unless evidence can be presented to show that the authority of the Act is substantially duplicated by other federal or state statutes. Currently available information indicates that this is not the case. However, those sections of the Act that are duplicative of another authority or unnecessarily restrict the financial transactions of registered holding companies should be reviewed and modified or repealed, if necessary.

The current provisions of the Act provide for continued surveillance of utility company operations which appears necessary to prevent possible abuse of the holding company device.

Electric utility diversification into many areas related to utility operations is permitted under the Act and has taken place. Substantial utility diversification into nonutility-related areas is fraught with dangers and may contribute to the long-term problems of the industry.

If the major impetus for electric utility diversification is inadequate returns to utility investments, as the industry suggests, this problem should be dealt with directly through efforts to secure additional rate relief rather than indirectly through nonutility diversification.

There is no evidence that electric utility diversification into nonutility activities will benefit the industry's investors or customers. Diversification does not improve earnings to utility operations any may subject those earning to increased risk. Also, society in general does not appear to benefit since these activities may be provided by nonutility companies as well as by utilities. Utility intrusion into these areas limits the ability of other companies to expand into new lines of business.

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[Whereupon, at 1:55 p.m., the subcommittee was adjourned.]

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